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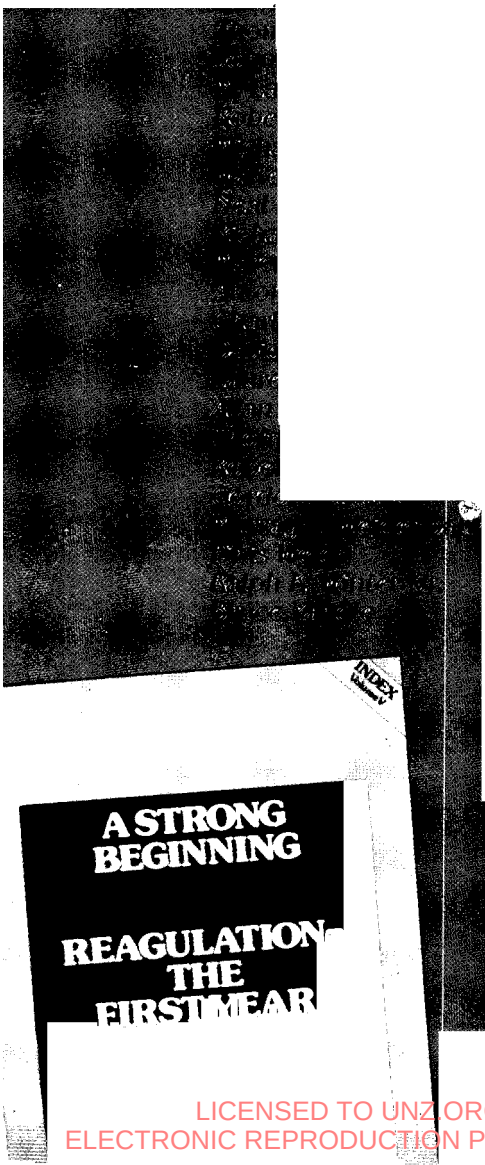

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Regulation

Mar/Apr 1982 AEI Journal on Government and Society

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LETTERS 2

PERSPECTIVES on Current Developments 5
Foreign Investors under Fire
Regulatory Calendar, R.I.P.?
Regulation and the 1983 Budget
New York City Looks at Taxi Regulation
In Brief—

THE FREEDOM OF INFORMATION ACT HAS NO CLOTHES 14
Antonin Scalia

IS REGULATORY RELIEF ENOUGH? 20
Marvin H. Kosters and *Jeffrey A. Eisenach*

CANADA'S CHICKEN-AND-EGG PROBLEM: The High Cost of Price and Output Controls 28
Paul K. Gorecki

AUTO INSURANCE— THE IRRELEVANCE OF REGULATION 37
Mark Nadel

DOES FATHER KNOW BEST? The Case of State Employment Agencies 43
William Papier

ABOUT KNOWLEDGE AND DECISIONS 47
A Review of Thomas Sowell's *Knowledge and Decisions*
William Havender

READINGS of Particular Interest 51

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Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Antitrust and the FTC

TO THE EDITOR:

Ernest Gellhorn has written a thoughtful and provocative article ("Two's a Crowd: The FTC's Redundant Antitrust Powers," *Regulation,* November/December 1981) that will sharpen the ongoing debate on whether the public interest would be better served by a monopoly in antitrust enforcement. While I might be persuaded to agree with him that one agency could do the job, I'm afraid I would prescribe a different remedy from his.

Congress created the FTC for several reasons: to reach anticompetitive problems in their infancy, to provide specialized competitive expertise that the courts lacked, and to ensure vigorous antitrust enforcement. One of the commission's most important roles is to help shape the legal and economic analysis that is used to interpret our antitrust laws. Because many of today's competitive problems are so complex, the courts increasingly have applied rule-of-reason analyses instead of routine per se rules—a critical change, for it is precisely in this area that the commission, which can give concrete definition to the rule of reason, has a distinct institutional advantage over the Antitrust Division. Indeed, Gellhorn recognizes the commission's importance in this regard, citing the *DuPont* and *Heublein* decisions and the agency's recent emphasis on analyzing horizontal problems in the professions.

Gellhorn quarrels with the commission's case selection, even on horizontal matters, and states that the Antitrust Division could satisfactorily handle "complicated cases" adequately. The wisdom of the commission's selection in the past, like the Antitrust Division's, will no doubt consume pages of commentary in future law review articles. But the commission's long-term impact is more accurately measured, in my judgment, by the end product of those cases: the rationale and guidance expressed in the commission's final decisions and orders, where it has increasingly incorporated relevant economic and business justifications into its legal framework. Moreover, as antitrust analysis becomes more sophisticated, the commission's adjudicative process will be an even more relevant forum for exploring economic and legal issues fully and carefully. Our analytical work will help the courts as well, as they grapple with antitrust cases of increasing complexity and economic import. The commission's unique decision-making structure lets it shape the contours of antitrust policy in a way that the Antitrust Division, with its necessarily limited prosecutorial focus, cannot.

Much of Gellhorn's criticism focuses on the commission's challenges to vertical restraints. I share his view that these practices should generally be treated with less hostility than they have in the past. I would point out, however, that the commission's recent record shows a clear shift in that direction, particularly with respect to non-price restraints. As for resale price maintenance, which I believe deserves close scrutiny because of its greater potential for adverse horizontal effects, the commission's Bureau of Economics has recently begun a thorough review of empirical studies, past commission cases, and other evidence to see whether a per se standard of illegality is still warranted. This work, too, illustrates the commission's special ability to guide the future direction of antitrust enforcement with sound economic analysis.

Thus, while it is possible that the Antitrust Division could handle all antitrust matters (although around 75 to 80 percent of its work has traditionally been confined to criminal price-fixing cases), that approach would ignore the inherent value of having two agencies, with different areas of institutional expertise and power, responsible for preserving and enhancing competition throughout our economy. Rather than overcrowding the field, the combined resources of the FTC and Antitrust Division guarantee that we enjoy the benefits of healthy and vigorous marketplace competition.

David A. Clanton,
Commissioner,
Federal Trade Commission

TO THE EDITOR:

One can readily conclude from Ernest Gellhorn's excellent article that he is displeased with the cases the commission brought during the last six years. Whether he makes a convincing case for the drastic step of abolishing the FTC's antitrust jurisdiction is another matter. (Here and throughout, I speak only for myself, not for the commission or any of its members.)

Despite Professor Gellhorn's insightfulness, his litany of thumbnail case sketches is no substitute for a careful review of the merits of each individual case, which the limitations of space allow neither him nor me. However, one generic response to a generic criticism is illustrative. Gellhorn criticizes the commission for bringing price-fixing cases against small firms in small industries, such as pest controllers and roofing contractors. Yet if the commission did not bring such cases, small businesses—which add up to a large amount of commerce—would soon perceive that they were largely exempt from the law.

Gellhorn contends that the commission's consumer protection duties inevitably taint the free-market principles that should govern its antitrust duties. I disagree. Competition and consumer protection share a common, market-oriented approach. The competition side of the FTC Act ensures that the free market produces a wide range of goods at the lowest price, without any manufacturer misconduct such as price-fixing. The consumer protection side of the act then ensures that consumers can freely choose from among these various goods, without any seller misconduct such as coercion or deception. Properly administered, both sides protect the free market. The Miller administration at the FTC has already begun

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to demonstrate this, though Gellhorn's article was written before the new management took over.

The next supposed structural failing of the FTC is susceptibility to special interest and congressional pressure. The Department of Justice is also familiar with political and private pressure, as Gellhorn admits, so there is no comparative advantage there. To abolish the FTC's antitrust authority, however, would be the ultimate caving-in to private interest pressure; indeed, that is just the prescription now sought by certain groups whose anticompetitive conduct the FTC has vigorously attacked. The FTC must be vigilant lest Congress or private interest groups sway its prosecutorial judgment, but so must every other government agency.

Finally, Gellhorn argues that all worthwhile FTC cases could have been handled equally well by the Justice Department. While most FTC actions proceed on antitrust theories which Justice is capable of pursuing, many cases benefit from the special procedural and substantive terms of the FTC Act. For example, the commission has been able to extend antitrust principles to professional associations, thus settling an uncertain legal issue, without subjecting the members of those groups to the possible unfairness of private treble damage actions as a Justice Department case would have done. And, contrary to what Gellhorn implies, the statutes administered by the Department of Justice do not exhaust all possible anticompetitive behavior. For example, pricing above the competitive level in an industry where there are few firms may be made much easier by certain practices short of an agreement between those firms, but the Sherman Act condemns only an agreement. The economic result, however, is the same: higher prices and less output; and only the FTC can prevent this result.

Moreover, Gellhorn entirely overlooks the tremendous congestion in federal district courts, where Justice must try its cases, and the greater sophistication of the FTC's judges and commissioners in antitrust matters compared with federal judges. Gellhorn's recitation of dubious decisions did not extend beyond FTC opinions. It is accepted teaching among economic analysts, however, that some of the greatest potential for misuse of antitrust law stems from misguided federal court decisions. Resale price maintenance, for example, which Gellhorn believes has been wrongly condemned, remains illegal per se by the Supreme Court's judgment, not the FTC's.

Gellhorn's basic concerns stem from his view that the commission has brought economically unsound cases in the past. As he himself acknowledges, however, the commission has done much better in recent years. I and other members of the present management are committed to completing that transformation.

Thomas J. Campbell, Director,
Bureau of Competition, FTC

TO THE EDITOR:

Ernest Gellhorn argues that the FTC's enforcement of the antitrust laws has not been limited to cases that enhance economic efficiency, not because of the agency's leadership, but because of two flaws in the agency's institutional structure.

First, he argues that the commission's consumer protection mission is not directed at economic efficiency, and that this affects the conception of its antitrust mission. This is a "structural" argument only if the substance of the consumer protection program results from something other than the views of the agency's leadership. If Gellhorn were chairman of the FTC, would he be unable to limit consumer protection cases to those that enhance economic efficiency? If some inexorable institutional forces would bind his hands, he would have the beginning of a structural argument. But he identifies no such forces.

The other reason Gellhorn cites is the FTC's vulnerability to "interest group pressure," exerted either indirectly through Congress or directly on the agency. Regarding the former, Gellhorn does not seem to say that the problem is Congress's "pressuring" the FTC to enforce specific antitrust laws (including those, like the Robinson-Patman Act, that are not directed at economic efficiency). Rather he suggests that Congress uses the FTC to obtain special favors for constituents. Gellhorn cites only one instance where he believes the commission "caved in" to congressional pressure—the 1973 complaint against the oil companies. This is a very curious example of special favors for constituents. And, in any event, one instance hardly makes a very convincing case, especially since the FTC might well have issued the complaint even without congressional pressure.

Gellhorn also asserts that certain matters—a consent order prohibiting a tying arrangement for mobile home sites, for example—can be explained only by interest group pressure applied directly on the agency. I happen to agree that such a consent order is misguided, but it is a matter on which reasonable minds can and do differ. Those who disagree with me on principle are quite capable of acting on those principles without any "interest group pressure."

I am not saying that reducing the amount of "improper influence" is not a worthwhile objective—though, since "interest group pressure" is the very heart of a democratic system of government, one must carefully define "improper." (Surely Gellhorn doesn't think that all efforts to persuade agency officials to undertake cases not enhancing economic efficiency are improper by definition.) Nor am I saying that various institutional structures may not differ in their susceptibility to improper influence. But Gellhorn does not identify or discuss these differences. He merely concludes that the FTC has been improperly influenced because it does things he thinks it shouldn't.

Political leadership has a dramatic effect on what government agencies do. Since Paul Rand Dixon was a great champion of the Robinson-Patman Act, it is not surprising that the FTC spent a lot of resources enforcing that act under his chairmanship. And since subsequent chairmen have not thought that the antitrust laws should be limited to achieving greater economic efficiency, it is not surprising that the FTC's antitrust record under these chairmen is found wanting when measured solely against the criterion of economic efficiency. Will the cases produced by Jim Miller and Tom Campbell be just like those produced by Mike Pertschuk and Al Dougherty? As Gellhorn concedes, the FTC did radically change the direction of its antitrust program in the 1970s, demonstrating that changes in substantive direction are not beyond the institutional capacity of the agency.

Gellhorn might respond that the commission's collegial structure and the fixed terms of its five commissioners will keep the commission's politically appointed management from shaping enforcement policies. If the management wants to do something that requires the approval of the full commission, such as issue a complaint, its power is indeed limited by the need to convince a majority of commissioners. But that does not explain why the

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commission would undertake projects opposed by management. The FTC operates on a "bottom-up" rather than a "top-down" basis. New law enforcement initiatives originate with the staff and filter upwards through the hierarchy to the commission. If the management does not want to forward a proposed case to the commission, it can simply close the matter on its own accord. This means, as a practical matter, that the management has tremendous, virtually unreviewable power to eliminate "bad" cases.

As one who has observed and participated in numerous FTC management evaluations of proposed antitrust investigations, I am keenly aware of differing management views regarding the appropriate objectives of antitrust enforcement, and also of the frequent reasonable disagreements about whether a case will enhance economic efficiency. I am not aware of any unique "structural" factors that force the agency's managers to adopt positions they disagree with on principle. One can only wonder why Gellhorn so assiduously avoids the fact that the commission's previous leadership simply had a different vision than his. Gellhorn's "structural" argument looks suspiciously like a "substantive" argument in disguise.

Despite my difficulties with Gellhorn's analysis, I think that a structural approach has promise for analyzing government enforcement of the antitrust laws. Such an approach should focus on the structural features of the "ideal" antitrust enforcement agency, and on whether they are more easily realized in an executive branch or an independent agency, and in one agency or two. Attacking the FTC's substantive record does not advance understanding of these structural considerations.

Thomas C. Armitage,
University of Washington

TO THE EDITOR:

Gellhorn's argument is so overdrawn as to be a little misleading. He bases his case on two lines of evidence: first, he does a biopsy of forty-four final orders issued by the commission in 1979 and finds about two-thirds "unjustified"; second, he reviews major commission cases and programs since 1975 and finds almost all of them similarly unproductive and wrong-headed.

On the first point, it should be understood that Gellhorn is applying a very special set of standards. He regards cases as justified only if the practices challenged are likely to create a cartel or exclude competitors, and he would usually leave even practices of that sort unchallenged if there were a significant efficiency defense.

That is an exceedingly narrow view of antitrust, one that has not been adopted by Congress and the courts. It's a little like defining "crime" to include only homicide and then complaining that the FBI is wasting 95 percent of its resources.

To take one glaring example, Gellhorn tags twelve vertical price-fixing cases as "unjustified"—even though the Supreme Court could not have been clearer in ruling that those arrangements are illegal regardless of any claimed efficiencies. While conservative antitrusters may find that rule cannot be supported, it's hardly fair to blame the FTC for enforcing the law in line with Congress's intent as interpreted consistently by the courts.

His argument that the FTC should be abolished because its *major* cases and programs since 1975 haven't measured up to his standards is similarly flawed. This approach must be handled with care because, by definition, it ignores the unglamorous, day-to-day enforcement on price-fixing, mergers, and other competitive problems that are the bulk of the FTC's work.

Gellhorn does spotlight some clear commission errors. The complaint against DuPont for taking advantage of its superior efficiency by expanding capacity rather than raising prices, a complaint that was eventually dropped by the full commission, may have been the "wrongest" case in ninety years of antitrust enforcement. But Gellhorn goes wrong when he tries to show that all the commission's other initiatives were comparably misguided.

He says the commission sued Borden when it was guilty of nothing more than selling ReaLemon at low prices. In fact, the central theory of the case was that Borden, with 90 percent or so of the market, was guilty of predation against small new entrants by selling close to or below out-of-pocket cost—a conventional theory even by conservative standards. Incidentally, a court of appeals affirmed the commission decision last week in a two-to-one vote. Maybe the court ought to be abolished too.

Gellhorn also cites some criticism of the FTC's "costly line-of-business program," repeating the charge that it is ineffective and "probably misleading." But the courts have consistently rejected those charges. In fact, the line-of-business data have been the basis of some remarkable new scholarship at the commission challenging conventional *liberal* views on merger policy. So much for the charge (not made by Gellhorn, but made by others) that the commission is a kangaroo court.

The commission accounted for more than its share of mistakes in the 1970s, and Gellhorn, as one of its ablest but severest critics, is adept at pointing them out. His case for merging antitrust enforcement in the Department of Justice is a formidable one, although I don't agree with it.

What I find objectionable in Gellhorn's assault is the tendency to simplify the issue by painting the commission's initiatives as virtually always misguided and inept. Life is rarely that simple. A more impressive case against the FTC would acknowledge its achievements, expose its mistakes, and trust AEI's readers to make their own informed judgments.

Robert Pitofsky,
Georgetown University Law Center,
Former Commissioner, FTC

ERNEST GELLHORN responds:

It may be true, as this quartet of FTC defenders would have it, that a more sympathetic reviewer could construct a case for the continuation of the FTC's antitrust authority from the very same events which, in my view, justify its demise. But I sought to develop a larger picture, going beyond individual prosecutions and other major actions, and focusing on what it is that continually makes the FTC misuse its resources and prosecute trivial or even beneficial business practices. It is therefore disappointing, and I think ultimately damaging to the defenders' case, that they merely pick away at bits and pieces of my analysis and ignore my larger challenge—namely, why has the FTC fared so badly compared with the Antitrust Division in antitrust enforcement?

Even accepting, for the sake of argument, that antitrust enforcement ought to be based on more than efficiency considerations, the efforts of these past and present FTC commissioners and staffers to defend their actions are so insubstantial that they provide further evidence for my case. David Clanton defends the FTC's existence on the grounds that, in exceptional cases, the commission's opinions have cor-

(Continues on page 60)

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Perspectives
on current developments

Foreign Investors under Fire

It is only a slight exaggeration to say that the United States was built with foreign money. Overseas investors financed the building of railroads and canals in this country, and as recently as 1914, investments by foreigners here were twice as large as investments by Americans abroad. Now, the ratio is four-to-one the other way: $192 billion versus $52.3 billion at the end of 1979, counting only direct investments.

Nearly everyone agrees that investment in both directions is highly beneficial to our economy and to those of our trading partners. But the direct stake held by foreigners in U.S. businesses and properties has recently grown—from $34.6 billion at the end of 1977 to $52.3 billion at the end of 1979. And friction with Japan and the Arab world has drawn attention to their investments here. Murmurs of discontent have begun to be heard, and have led to an inquiry into the subject by the House Commerce Committee's Subcommittee on Commerce, Consumer, and Monetary Affairs, chaired by Representative Benjamin Rosenthal (Democrat, New York).

There was a flurry of agitation a few years ago about foreign purchases of American farms, but that subsided when it was shown that total foreign holdings made up less than 1 percent of all U.S. farmland. Most current concerns of the critics of foreign investment fall into four categories:

- *National security.* Rosenthal's House panel has held hearings on Saudi Arabian investments in the Whittaker Corporation, a large defense contractor, and on the Kuwaiti government's $2.5 billion purchase of the Santa Fe International Corporation, a California firm that, among other things, drills for oil and builds nuclear power plants. (Kuwaiti and Santa Fe spokesmen denied that the new owners would abuse the firm's nuclear technology or lead it into OPEC oil embargoes.) It is hypothetically possible, it might be noted, for Communist countries to establish or buy capitalist businesses here; this has already happened in West Germany, where Bulgaria has bought a machine-tool company and Yugoslavia a consumer radio firm.
- *Compliance with U.S. law.* Several well-known Japanese companies operating here have been accused of violating race and sex discrimination laws by hiring only Japanese men for management posts. The companies defend their actions by citing a 1953 treaty between Japan and this country that lets Japanese firms hire executives, technical experts, and other specialists "of their choice." (The United States has a number of other treaties along these lines with other trading partners.)

The Supreme Court may rule on the issue soon in a class action case brought by women employees of Sumitomo America Inc., a New York trading company whose parent firm had brought in Japanese men as managers. In an amicus brief requested by the Court and filed March 12, the Justice Department argued that the treaty does not protect companies that, like Sumitomo, incorporate their American subsidiaries under U.S. law.

- *Foreign state control.* Nothing, perhaps, is so well calculated to rouse the fears of liberals, conservatives, and nationalists all at once as a multinational corporation that is also an arm of a foreign socialist government. Such state-run enterprises are often distrusted because it is thought that they act for reasons of state instead of profit and that the deep pockets of their owners give them a competitive advantage.

Among the important U.S. businesses now controlled by foreign states are Kennecott, the largest producer of copper (part of Standard Oil of Ohio, a subsidiary of British Petroleum), American Motors (Renault), and several rail-

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roads (Canadian National Railway). Texasgulf, Inc., a leading producer of sulfur and fertilizer, has the unusual distinction of having been controlled first by one state enterprise (Canada Development Corporation) and then by another (Elf-Aquitaine, a French oil firm). The recent wave of nationalizations under French President François Mitterrand has brought several more American firms into the state-owned category.

Although foreigners who operate here are subject to antitrust law, it would not be easy to break up a government's holdings. Under U.S. banking laws, no domestic firm could simultaneously own banks and major industrial companies here, as several Western European governments do.

• *Reciprocity.* U.S. firms sometimes complain that while they are barred from making investments in another country, that country's citizens or government are perfectly free to make similar investments here. This issue of reciprocity seldom comes up with respect to Third World countries, which make few investments here, or for that matter industrial countries, most of which have investment policies that American firms have learned to live with.

The big exception is Canada, which has both extensive investments in this country and a set of controls on foreign investment that strikes many American companies as unduly restrictive. Canada's Foreign Investment Review Agency (FIRA), established in 1973, has had the power since 1975 to screen new investments by foreign firms to see if they are "likely to be of significant benefit to Canada." Even when it does not turn them down outright, it often extracts pledges of buy-Canadian policies or technology transfers. Ottawa is also using government procurement powers to try to "Canadianize" the office equipment industry, and other industries may follow.

Most controversial of all is Prime Minister Pierre Trudeau's National Energy Program, announced on October 28, 1980, which seeks to increase the Canadian-owned share of the country's oil industry to 50 percent by 1990 from less than 30 percent in 1979. The program includes enough features that favor Canadian-owned oil firms that, after it was announced, several American firms sold their holdings to Canadian firms at bargain prices. At the same time, whether by coincidence or not, Canadian firms tried to take over or buy large stakes in several U.S. oil and mining firms, sometimes against the will of the latter's managements. The furor that these bids aroused in the affected American industries soon spread to other sectors: major truckers complained that Canadian firms could easily enter newly deregulated U.S. routes while Americans faced legal obstacles when expanding in Canada.

'Yes, this is a good site for your first auto plant in the U.S., Mr. Moto . . . I'll check and see if the Arab owners will sell it.'

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Congress came out against the Canadians with guns blazing. A House subcommittee voted to slap a nine-month moratorium on foreign purchases of firms that hold federal mineral leases. Another moratorium bill specifically named Canada as its target. The proposal that is furthest along (it has passed the House and a Senate committee as of this writing) would extend U.S. regulations on the buying of securities on credit (margin borrowing) to foreigners who borrow money abroad to buy stock here. This may be mostly a symbolic blow, since the rules are easily evaded even by most American stock buyers (see "Lifting Burdens at the Margin," *Regulation*, July-August 1981).

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In the wings is far more stringent legislation introduced by Congressman Rosenthal to create an agency not unlike Canada's FIRA that would be empowered to delay or prohibit some foreign investment. Rosenthal's bill would also create a central registry to identify all foreign holdings, and would prohibit foreign governments from controlling American firms in selected industries.

While the Reagan administration has tried to hold Congress back from retaliatory moves, it has taken a number of steps on its own. It gave notice in March that it will charge Canada with violations of the General Agreement on Tariffs and Trade. The Interior Department considered, but on February 3 decided against, revoking Canada's "reciprocal" status under the Mineral Lands Leasing Act of 1920, which denies mineral leases on federal lands to citizens of countries that do not allow similar rights to U.S. citizens. The Interstate Commerce Commission began an inquiry into trucking reciprocity. And a spokesman for the office of Special Trade Representative William Brock told Congress on February 23 that the administration has included investment in an overall review it is now conducting of the trade reciprocity issue.

Some of the retaliatory measures, especially reciprocity requirements, are intended to nudge other countries toward relaxing their own rules. Aside from whether such a tactic would work, the State Department warns that it could be a nightmare to administer different rules for each country's investors and that in any event bilateral investment has led to friction with only a few of our trading partners. There may be little point to special sanctions against state-owned firms, since it can be difficult to distinguish their behavior from that of private firms. Some of the former are not subsidized, and some of the latter are both subsidized and heavily state-influenced. (The track record of nationalized firms in international commerce, at any rate, suggests that American firms may have little to fear from their competition.) Sanctions against state firms would surely invite retaliation by some of our major trading partners.

It is also conceivable that Canada, for one, will rethink its nationalist policies, not because of U.S. pressure but because of the damage those policies are doing to the Canadian economy. The number of oil rigs operating in Canada declined 43 percent after the National Energy Program was proposed, and 128 rigs were moved to the United States, according to the Interior Department. The Canadian stock market has suffered its biggest crash since the Depression, with the prices of local oil company stocks, which were expected to benefit from "Canadianization," falling with the rest. Indeed, one reason Canadian companies have given for making big new investments in this country is the shrinking opportunity back home.

Regulatory Calendar, R.I.P.?

The sixth and final edition of the semiannual *Calendar of Federal Regulations*, issued January 13, 1982, marks the end of a brief and inconclusive experiment in regulatory management. The U.S. Regulatory Council, which began publishing the calendar in February 1979, was abolished last March. The last two editions of the calendar were compiled by the Regulatory Information Service Center (RISC).

The calendar was a listing of upcoming "major" regulations. "Major" was originally defined to include those "having an economic impact of $100 million or more," those "causing major cost increases for industry, government or regions," and any others the submitting agency might choose. Later editions added new criteria for inclusion, such as the likelihood that the rule might have significant effects on competition, investment, productivity, or the ability of American firms to compete with foreign-based enterprises (this last category added under the Reagan Administration).

In format, the final edition of the calendar did not differ greatly from the second edition, reviewed in these pages two years ago ("The Regulatory Calendar: A Catalog without Prices," Perspectives, January/February 1980). Two new sections had been added to the summaries of individual rules: a "reason for including this entry," added in May 1980, and a summary of net benefits, which, since agencies were already furnishing summaries of costs and benefits, was unlikely to hold many surprises. There were also new timetables for upcoming comment periods, hearings, and meetings. The list of "sectors affected by regulatory action"

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had increased from eight in the second edition to twelve.

Of the 167 regulations in the final edition, 90 were repeats from previous calendars, and some, like the Department of Health and Human Services' "Conditions of Participation for Nursing Homes," had been around since the very first edition. There was a definite change in tone in the final edition, however: many of the holdover proposals had revised their summaries of benefits to sound far less sanguine, and a large number of the newly proposed regulations were regulatory rollbacks.

The calendar never overcame its central defect as a regulatory reform tool. It was, in the words of one reformer, the "agencies' baby," and as such reflected the agencies' own views on issues, often views highly resistant to regulatory reform. Neither RISC nor the Regulatory Council before it had any authority over the agencies it dealt with: Guidelines for agency submissions to the calendar could be issued, but not really enforced. RISC functioned largely as an editorial board, receiving submissions from agencies, looking them over, and sending them back with suggestions for clarification. The agencies could then either alter their submissions or resubmit with further explanations. About the most demanding request RISC could make of the agencies was in the realm of syntax: "Use the active voice rather than the passive voice whenever possible." RISC's executive director, Mark Schoenberg, even included along with the calendar an explicit disclaimer that "the Center is not . . . responsible for the accuracy or completeness of agency materials."

The calendar was evidently of only marginal usefulness to the private sector. By the time each semiannual calendar appeared, many larger companies and interest groups, which have their own staffs to keep up with agency plans, already knew more about a listed regulation than the calendar could tell them. An official of a large automaker said: "If I hadn't asked my staff what they thought about the calendar's demise, they never would have missed it." For some smaller concerns with no government affairs staff in the capital, however, the calendar may have served as an early warning device. And former Regulatory Council director Peter Petkas suggests that the more varied an interest group's concerns, the more likely it was to find the calendar useful.

The calendar was undoubtedly most helpful to the federal agencies themselves, in prompting some of them to think through the effects of their proposals. Since RISC could not contest the agencies' analytical assumptions, it is true, the diligent agency had to be something of an autodidact: if for the public the calendar was a catalog without prices, for the agencies it was an examination without grades. Accordingly, "educational" attainments varied greatly among agencies. By the last issue, agencies like the Occupational Safety and Health Administration and the Consumer Product Safety Commission, lectured as they have been by economists for these many years, were giving detailed estimates of costs for many of their proposals. (How accurate those estimates were is, of course, another question.) Many other agencies, however, either failed to offer cost estimates or, against all likelihood, predicted that costs would be minimal. This tendency was especially apparent on the part of the agencies administering affirmative action and other social programs—so that regulations with compliance costs in the "minimal" category included rules to ban sex discrimination in police training, age discrimination throughout the criminal justice system, and sexual harassment and intimidation in workplaces everywhere. Even among social programs, however, a specific estimate sometimes snuck through, as with the Department of Transportation's estimation that full accessibility for wheelchair transit could cost as much as $57.75 a trip. In any case, this educational value of the calendar is now provided more effectively—because not entirely autodidactically—through the Regulatory Impact Analysis program of OMB.

The *Washington Post* reported January 15 that the calendar was probably canceled as a cost-cutting move. RISC cannot say how much the calendar cost in all, since the agencies did not keep track of what it cost them to prepare their entries. The only hard-and-fast figure available was the allotment for RISC's own salaries and expenses in fiscal year 1982, which was $900,000.

RISC says it intends to replace the calendar with a new computerized digest of developing federal regulations. Officials at the Office of Management and Budget say they cannot give an estimate of how much this new system will cost, but it sounds economical: although it will

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cover "non-major" as well as "major" regulations, it will contain little evaluative detail. So far, plans call for no guidelines for agency submissions and no analysis of individual rules. RISC says the new system, which is still nameless, will be ready by the end of this year.

Another substitute for the calendar might be the semiannual agendas of upcoming rules that the agencies now issue under Executive Order 12291. The regulatory reform bill passed by the Senate March 24, S. 1080, would require the agendas by law, and would also bring their contents together every May and November in the form of a calendar. So an obituary for the regulatory calendar is somewhat premature.

Regulation and the 1983 Budget

As recently as last fall, it was still unclear whether the Reagan administration was actually reducing the budgets and staff levels of the federal regulatory agencies, or merely halting their growth. Last year's 1982 budget proposed minor cuts in real terms for most regulators, along with increases for such agencies as the Environmental Protection Agency and the Occupational Safety and Health Administration. Now, with the appearance of the proposed 1983 budget, it has become clear that the Reagan administration not only intends to cut the budgets and staffs of most major regulators substantially, but has already made measurable progress towards that end.

The summary figures shown here are taken from the annual roundup of regulatory agency budgets and staffs prepared by the Center for the Study of American Business at Washington University. The figures do not take into account congressional action on the 1983 budget, which is expected later this year.

One reason for the sharp decline in this year's figures (fiscal 1982) is that the new spending estimates are coming in well below the targets set in President Reagan's original 1982 budget. Whereas that budget proposed a 4 percent real cut in regulatory funding from 1981 levels, the estimate now is 10 percent, according to the Center's figures. And the 3 percent cut scheduled for staffing has been revised upward to 9 percent. The declines are all the more significant because all government agencies, including regulatory agencies, have historically tended to overshoot rather than undershoot their budget and staffing projections.

The 1983 budget, if passed intact, will continue the shrinking process. Real spending by regulatory agencies will be cut another 7 percent, and staffing another 3 percent, from the estimated 1982 levels. In the three years from 1980, which now looks like the high-water year for regulatory endeavor, through 1983, the agencies will have lost one-sixth of their real budgets and one-seventh of their personnel.

One of the biggest proportional cuts for fiscal 1983 is slated for energy regulation. The Department of Commerce's regulatory programs, inherited from the Department of Energy, are scheduled to fall from $46 million to $14 million, or 70 percent, and the Justice Department's petroleum regulatory activities from $46 million to $21 million, or 54 percent. The Civil Aeronautics Board, proceeding on its way to oblivion, is falling by 32 percent, from

EXPENDITURES ON FIFTY-SEVEN REGULATORY AGENCIES
Selected Fiscal Years, 1970–83

Area	1970	1979	1980	1981	1982 (est.)	1983 (est.)
	EXPENDITURES ($ billions)					
SOCIAL REGULATION						
Consumer Safety & Health	$ 0.4	2.2	2.4	2.7	2.4	2.5
Job Safety & Other Working Conditions	$ 0.1	0.6	0.7	0.8	0.8	0.8
Energy & the Environment	$ 0.1	1.5	1.9	2.1	2.2	2.0
	$ 0.5	4.4	5.1	5.6	5.3	5.3
ECONOMIC REGULATION						
Finance & Banking	$ 0.1	0.3	0.3	0.4	0.4	0.4
Other Industry-Specific	$ 0.1	0.3	0.4	0.4	0.3	0.3
General Business	$ 0.1	0.3	0.3	0.3	0.4	0.3
	$ 0.3	0.9	1.0	1.1	1.1	1.0
TOTAL	$ 0.9	5.2	6.1	6.6	6.4	6.3
TOTAL IN 1970 DOLLARS*	$ 0.9	2.9	3.1	3.1	2.8	2.6
PERMANENT FULL-TIME POSITIONS (thousands)						
SOCIAL REGULATION	9.7	64.2	66.4	63.6	57.1	54.8
ECONOMIC REGULATION	18.0	24.0	24.1	23.0	22.2	21.7
TOTAL	27.7	88.2	90.5	86.7	79.3	76.5

*Adjusted by GNP deflator (actual and, for later years, estimated in budget).
Source: Center for the Study of American Business.

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$113 million to $77 million, while the Federal Trade Commission, having curtailed its enforcement activities considerably, will take a 10 percent cut, from $68 million to $61 million. The Environmental Protection Agency will be cut 6 percent—from almost $1.4 billion in 1982—but at $1.3 billion will still be the largest regulatory agency.

A few agencies' expenditures are declining on paper because they are being funded by user fees instead of congressional appropriations. The Patent and Trademark Office in the Department of Commerce, for instance, is absorbing an apparent budget cut of about one-half in real terms, but because of higher user fees is actually expanding its staff by 10 percent. Similarly, a boost in user fees largely offsets a nominal 76 percent reduction in the budget of the Federal Grain Inspection Service. (The Center's newest tables, incidentally, exclude Agriculture Department programs to "strengthen markets," which had been included in "consumer safety and health" in past years' tables.)

Staffing figures tell a more dramatic story, if only because they are not affected by inflation. Such agencies as OSHA, the FTC, the Consumer Product Safety Commission, and the Federal Communications Commission will have lost one-fifth or more of their staffs between 1981 and 1983.

Do these reductions translate into a real reduction in the regulatory burden? Will the people who are regulated notice the difference if one out of every five regulators disappears? To some extent, they surely will, even if the remaining regulators work harder to make up for their lost colleagues. Still, it helps keep the latest cuts in perspective to compare them with the earlier days of regulatory growth. During the 1970s most agencies

CHANGE IN EMPLOYMENT FOR TWENTY-EIGHT REGULATORY AGENCIES

Agency	Permanent Full-Time Positions 1981	1982	1983	Percent Increase (Decrease) 1981–83
Consumer Product Safety Commission	812	631	577	(28.9)
Food and Drug Administration	7,521	7,142	7,169	(4.7)
Antitrust Division	939	829	789	(16.0)
Federal Railroad Administration	431	421	445	3.2
National Highway Traffic Safety Administration	797	686	686	(13.9)
Bureau of Alcohol, Tobacco, and Firearms	3,671	2,454	[2,450][a]	(33.3)
TOTAL, *Consumer Safety & Health*	14,171	12,163	12,116	(14.5)
Mine Safety & Health Administration	3,808	3,471	2,996	(21.3)
Occupational Safety & Health Administration	3,009	2,354	2,354	(21.8)
Equal Employment Opportunity Commission	3,412	3,316	3,278	(3.9)
National Labor Relations Board	3,213	3,213	3,213	—
TOTAL, *Job Safety & Other Working Conditions*	13,442	12,354	11,841	(11.9)
Energy Programs, Department of Commerce	[429][b]	159	135	(68.5)
Office of Surface Mining	1,036	737	638	(38.4)
Environmental Protection Agency	9,799	9,243	8,054	(17.8)
Nuclear Regulatory Commission	3,029	3,325	3,303	9.0
TOTAL, *Energy & the Environment*	14,293	13,464	12,130	(15.1)
Comptroller of the Currency	3,071	3,071	2,925	(4.8)
Federal Deposit Insurance Corporation	3,554	3,521	3,550	(0.1)
Federal Home Loan Bank Board	1,440	1,463	1,465	1.7
National Credit Union Administration	601	600	574	(4.5)
TOTAL, *Finance & Banking*	8,666	8,655	8,514	(1.8)
Civil Aeronautics Board	650	505	427	(34.3)
Commodity Futures Trading Commission	550	550	550	—
Federal Communications Commission	2,004	1,862	1,602	(20.1)
Federal Energy Regulatory Commission	1,607	1,648	1,789	11.3
Federal Maritime Commission	306	306	290	(5.2)
Interstate Commerce Commission	1,836	1,653	1,450	(21.0)
TOTAL, *Industry-Specific Regulation*	6,953	6,524	6,108	(12.2)
Patent & Trademark Office	2,834	2,864	3,151	11.2
Federal Election Commission	235	202	212	(9.8)
Federal Trade Commission	1,587	1,380	1,235	(22.2)
Securities & Exchange Commission	1,928	1,860	1,765	(8.4)
TOTAL, *General Business*	6,584	6,306	6,363	(3.4)
TOTAL, TWENTY-EIGHT AGENCIES	64,109	59,466	57,072	(11.0)

[a] Staffing distributed to Customs Service and Secret Service.
[b] Economic Regulatory Administration, Department of Energy.
Source: Center for the Study of American Business.

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nearly doubled the size of their staffs. The increase in some areas was vastly disproportionate to the average—for example, labor and workplace safety regulation nearly quadrupled. The average agency's staff is currently shrinking at about the same rate—16 percent in the three years from fiscal 1981 to 1983—that it was growing back in those years.

New York City Looks at Taxi Regulation

Under New York City law, anyone who wants to offer taxicab service must buy from some other operator the right to do so, in the form of a "medallion" originally issued by the city. Economists have long used this medallion system as their favorite example of the adverse effects of limiting entry into an industry. It is also a prime example of how difficult it is to change a restricted entry system that has long been established. Not only have the beneficiaries of the system (the medallion holders) become well organized and politically potent, but most of them have acquired a plausible equitable claim to their position—in this case by purchasing the originally free medallions from former holders at a price which reflects the monopoly rents, so that the real beneficiaries of the government subsidy have long since departed the scene. Moreover, other segments of society, the financial community in particular, have acted in reasonable reliance on the established system. As a result, destroying the value of monopoly operating rights without "buying out" the existing holders is open to the charge of injustice—a charge that is especially difficult to resist when the holders are small entrepreneurs such as cab drivers. On the other hand, any proposal to "buy out" the rights is open to the even more heinous charge of political naiveté.

The difficulty is well illustrated by the work of a special panel appointed by Mayor Edward Koch to make recommendations for reform of the city's taxi regulation. The Mayor's Committee on Taxi Regulatory Issues, as it is called, came out with a preliminary report on October 22, 1981, and a final report on March 29, 1982. Although its final report makes no less than seventy-three proposals for altering taxi regulation, few, perhaps none, pose any serious threat to the interests of current medallion holders.

The New York City government has regulated taxicabs for a very long time: fares alone have been under control since at least as far back as 1817. The Haas Act of 1937 for the first time inaugurated the practice of limiting the number of cabs that could legally operate in the city. The municipal government issued a medallion to each of the city's 13,595 cabs—a number that had fallen from a peak of about 21,000 in 1931. The number of cabs continued to drop during the Second World War, and the market became so weak that about 1,700 owners chose to turn in or not to renew their medallions. Later, with rising taxi demand, medallions acquired a positive resale value. In 1971 the number of medallions was fixed by law at 11,797, and it can now be changed only by City Council action. Fares are set by the city's Taxi and Limousine Commission, and the industry is expected to provide detailed cost documentation when it proposes a rate increase, although the TLC frequently finds the resulting data "incomplete" and "unreliable."

Medallion holders, the mayoral panel notes, "have substantial investments in the existing system." The going rate for a single medallion has recently been around $50,000–$60,000, far more than the cost of the vehicle itself. At recent prices, the market value of all medallions amounts to something like $600 million. Most new taxi owners put up both their vehicles and their medallions as collateral for bank loans. There are from $250 million to $400 million worth of these loans outstanding, including some made by the Small Business Administration, the report says.

Several positive advantages have been claimed for the medallion system. Among them are easing traffic congestion, preventing "ruinous competition" among drivers, and improving service by giving owners the financial means to pay for needed repairs and upkeep. Since owners typically must make large payments on medallion loans, however, it is not clear that their overall finances are really as healthy as the last two arguments would imply.

Perhaps the most unusual argument for medallions is that they provide a built-in retirement system for taxi drivers. The report notes that if drivers use their medallions as a means

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In Brief–

Recipe for Chaos? Over in Great Britain, Prime Minister Margaret Thatcher's budget-cutting policies may be about to claim another victim: the bureau in the agriculture ministry that keeps itself busy compiling, printing, and sending out recipes. Neither memories of World War II (when it did its patriotic bit to help Britons stretch skimpy rations) nor a futile attempt to disguise itself as part of a "food research program" has saved the recipe bureau from likely extinction. Up to now, as the *Economist* of London points out, the civil service chefs have survived any number of attempted cutbacks, arguing that "only they can prevent 'erroneous or dangerous recipes being published.'"

That's Incredible! Some say that the most scientific measure of the pace of federal regulatory activity is the WLI—the Washington Lawyer Index. In recent years it has been soaring, as law firms from New York to California opened Washington offices and staffed them with often sizable numbers of attorneys. With the massive AT&T and IBM antitrust cases, energy regulation, and new EPA and FTC rulemakings, there was plenty for them to do.

But in the past few months, perhaps for the first time since the demobilization after World War II, the WLI seems to be heading downward. Few new branch offices are being opened; some out-of-town firms are recalling partners and associates previously assigned to Washington; and at some of the major D.C. firms, the class of 1982 (the associates asked to stay on as partners instead of leaving the firm) is unusually small. The situation is aggravated, of course, by the meager promotion prospects (and hence the urge to depart) of the government lawyers who used to manage the programs that had kept the private attorneys busy.

S'funny. Jimmy Carter was the one who was supposed to hate lawyers.

Dribblers' Rights. In another first for due process, a federal district judge has ruled that the University of Minnesota violated a student's constitutional rights when it dropped him from its basketball team. School officials had declared the student ineligible after the dean charged him with handing in work prepared by other students and withdrawing from several courses he was failing. Judge Miles W. Lord ruled that the student's place on the team, which might after all lead to a lucrative career with the pros, was a constitutionally protected interest and thus could not be taken away without a hearing.

The Five-Foot Shelf. Whatever the effect of regulation on the economy at large, it has given a big boost to the publishing industry. The latest evidence of this is the comprehensive, two-volume *Handicapped Requirements Handbook*, put out by the private Federal Programs Advisory Service and now in a sixth printing. This tome, to quote the publishers' brochure, covers not only the all-important Section 504, "the basic government-wide compliance requirements" on the handicapped, but also Section 503, "the 'affirmative action' requirements affecting federal contractors with one or more contracts of $2,500 or more," and Section 502, "the 'barrier free' architectural requirements affecting recipients who own, lease or use facilities constructed with federal financial support."

The diligent compliance officer can deal with day-to-day problems by consulting one of the volume's twenty-seven chapters on particular agency rules, or perhaps one of the loose-leaf appendixes. Number seven is on "Technical Information," and number six contains "Self-evaluation and Checklist." Since "the compliance requirements are in a constant state of flux," anyone in charge of one of those $2,500 contracts will also not want to be without the six-page monthly newsletter that comes free along with the book. And for those compliance emergencies, there is a "Handicapped Requirements Hotline" telephone service. It's free too.

Taking Regulation for Granite. *Forbes* magazine recently profiled the little-known Vulcan Materials Co., which dominates the unglamorous business of crushed stone. Vulcan earns a profit of nearly ten cents on every sales dollar, making it one of the most profitable companies in the United States. Its president told *Forbes* one of the reasons why. "Back in the Sixties you used to worry about who was going to open up a quarry right down the road, but now we never concern ourselves about that; problems with zoning and the EPA are so monumental. That gives us an ability to price our product that we didn't have before."

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of financing their retirement, they have chosen a very expensive means: "the entire retirement fund is purchased at the outset of employment, largely with borrowed dollars on which relatively high interest charges [must] be paid. . . . This is the reverse of normal retirement funding," where the money that is gradually salted away earns interest and has the advantage of favorable tax treatment.

None of these defenses of the medallion system was endorsed by the mayoral panel, which, indeed, concluded that the system had "sufficient disadvantages to the City that the Committee does not wish to see it replicated or reinforced." Neither, however, does it wish to see it replaced or substantially weakened. The panel's very first recommendation is to avoid watering down current medallions: "No new transferable medallions should be issued at this time." (It did favor issuing a number of

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new non-transferable medallions to cabs driven by off-duty police officers, a step that might, by improving driver safety, actually increase medallion values.) As the panel explained, it "recognizes that a number of medallion owners and financers have acted under a system permitted to operate by the City."

The cost of buying a medallion is not supposed to be included in the rate base on which the TLC computes taxi fares—a provision that clearly is evaded in practice, since otherwise the value of medallions would presumably fall to zero. (The system is in this respect similar to the quota and price-setting system in Canadian agriculture discussed later in this issue: see Paul Gorecki, "Canada's Chicken-and-Egg Problem: The High Cost of Price and Output Controls," p. 28.)

The TLC permits surcharges for certain types of service that are especially costly to provide. In 1981 it began allowing a fifty-cent surcharge for night and weekend service, which had been scarce; the mayoral panel calls for ending this surcharge. "Voucher" services, which dispatch radio cabs in response to calls by regular customers with charge accounts (such as business firms), could until recently collect a surcharge of any agreed-upon size for each ride. This type of service grew so rapidly —the thirteen radio cab groups now serve 12,000 voucher accounts—that, amid complaints that regular taxi service was suffering, the TLC froze the size of the voucher surcharges in September 1979. The mayoral panel gingerly proposes eventual deregulation of radio-cab surcharges, both for voucher and for regular customers (for whom no surcharge is presently allowed), "unless the TLC were to make findings, after public notice and comment, that taxi service in the City is being adversely affected"—which is to say, unless the TLC declines to change its mind.

Private, non-medallion cabs may legally respond to telephone calls, if they have a livery license, but may not pick up a customer who hails them on the street. Most of them, however, do not apply for such licenses, preferring to operate illegally (and pick up street customers). Estimates of the total number of non-medallion cabs, including the illegal ("gypsy") cabs, range from 8,000 all the way up to 40,000, the latter being nearly four times the number of legal medallion cabs. Gypsy cabs are most likely to serve poorer neighborhoods and outlying boroughs of the city, while medallion cabs concentrate on the relatively safe and lucrative Manhattan business. A 1972 study of taxi usage in central Brooklyn found that 85 percent of taxi trips originating there were in non-medallioned vehicles.

The panel recommends legalizing the gypsy cabs, which would let the city bring them under regulation. Non-medallion cabs, which would be painted with a green stripe, would not be limited in number and could pick up passengers throughout the city except at the airports and in Manhattan south of 96th Street. The green-stripe cabs would be slightly less heavily regulated than the medallion cabs, under the panel's proposals, though of course far more heavily regulated than they are in their present *tziganesque* condition.

It is common, though illegal, for a driver to refuse a paying customer because of his intended destination. Sometimes the motive is financial: the driver does not expect to find a paying customer on the way back. Often, however, the driver fears for his personal safety. The mayoral panel describes the common carrier obligation as a quid pro quo for the right to operate a medallion cab, and calls for police to enforce the ban on refusals "vigorously." The city government "cannot . . . acknowledge that neighborhoods which are too dangerous for taxi drivers are acceptable living environments for many of the City's poorer residents."

The panel also proposes several other regulations to combat what it perceives as a shortage of taxi service. For example, it proposes that the city check each cab's meter and odometer every six months to make sure it has driven a certain number of miles. The TLC already requires fleet-owned vehicles to "double-shift," that is, to run two nine-hour shifts each day. Double shifting is unpopular with many owners, not least because the logical time to change shifts, which is 4:00 or 5:00 P.M., puts the cab out of service during much of the peak afternoon rush hour. Although the TLC has tried to nudge the fleets toward obedience by ordering them to buy two shifts' worth of auto insurance, many of them still seem to be holding out.

One reason the rule is hard to enforce is that the old division between fleet and individ-

(Continues on page 36)

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THE FREEDOM OF INFORMATION HAS NO CLOTHES

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ACT

Antonin Scalia

THE FREEDOM of Information Act (FOIA) is part of the basic weaponry of modern regulatory war, deployable against regulators and regulated alike. It differs, however, from other weaponry in the conflict, in that it is largely immune from arms limitation debate. Public discussion of the act displays a range of opinion extending from constructively-critical-but-respectful through admiring to enthralled. The media, of course, praise it lavishly, since they understandably like the "free information" it promises and provides. The Congress tends to agree with the media. The executive branch generally limits its criticism to relatively narrow or technical aspects—lest it seem to be committing the governmental equivalent of "taking the Fifth." The regulated sector also wishes to demonstrate that it has nothing to hide, and is in any case torn between aversion to those features of the act that unreasonably compromise its interests and affection for those that unreasonably compromise the government's. Through the mutually reinforcing praise of many who should know better, the act is paraded about with the veneration normally reserved for the First Amendment itself.

Little should be expected, then, of efforts now under way in both houses of Congress to revise the act. But however dim the prospect for fundamental change, the FOIA is worth examining, if only as an academic exercise. It is the Taj Mahal of the Doctrine of Unanticipated Consequences, the Sistine Chapel of Cost-Benefit Analysis Ignored.

Antonin Scalia, the editor of Regulation, *is professor of law at the University of Chicago.*

Almost all of the Freedom of Information Act's current problems are attributable not to the original legislation enacted in 1966, but to the 1974 amendments. The 1966 version was a relatively toothless beast, sometimes kicked about shamelessly by the agencies. They delayed responses to requests for documents, replied with arbitrary denials, and overclassified documents to take advantage of the "national security" exemption. The '74 amendments were meant to remedy these defects—but they went much further. They can in fact only be understood as the product of the extraordinary era that produced them—when "public interest law," "consumerism," and "investigative journalism" were at their zenith, public trust in the government at its nadir, and the executive branch and Congress functioning more like two separate governments than two branches of the same. The amendments were drawn and debated in committee while President Nixon was in the final agony of Watergate, and were passed when President Ford was in the precarious early days of his unelected term. The executive branch managed to make a bad situation worse, by adamantly resisting

The Freedom of Information Act is the Taj Mahal of the Doctrine of Unanticipated Consequences, the Sistine Chapel of Cost-Benefit Analysis Ignored.

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virtually all changes in the act, even those that Congress was obviously bent on achieving. By the time it realized the error of its obstinacy, it was too late: the changes had been drafted and negotiated among congressmen and committees without the degree of agency participation and advice that might have made the final product—while still unpalatable—at least more realistic. The extent of the disaster may be gauged by the fact that, barely two months after taking office as a result of the Watergate coverup, President Ford felt he had to veto a bill that proclaimed "Freedom of Information" in its title. It passed easily over his veto.

When one compares what the Freedom of Information Act was in contemplation with what it has turned out to be in reality, it is apparent that something went wrong. The act and its amendments were promoted as a means of finding out about the operations of government; they have been used largely as a means of obtaining data in the government's hands concerning private institutions. They were promoted as a boon to the press, the public interest group, the little guy; they have been used most frequently by corporate lawyers. They were promoted as a minimal imposition on the operations of government; they have greatly burdened investigative agencies and the courts. The House Committee Report estimated that the 1974 amendments would cost only $100,000 a year; a single request under them has cost more than $400,000. There has grown up, since 1974, an entire industry and profession based upon the Freedom of Information Act. An organization has been formed, the American Society of Access Professionals, composed of men and women (mostly government employees) who have made their careers in this field. A two-volume FOIA loose-leaf service, updated monthly, retails at $438 a year; another one, supplemented only semiannually, is somewhat cheaper. Every week the *Legal Times of Washington* runs a page or more of notable new FOIA filings —mostly to enable corporate lawyers to find out what it is that other corporate lawyers are trying to find out. The necessary training for any big-time litigating lawyer now includes not only the cross-examination of witnesses, but use of the Freedom of Information Act. In short, it is a far cry from John Q. Public finding out how his government works.

The act and its amendments . . . were promoted as a boon to the press, the public interest group, the little guy; they have been used most frequently by corporate lawyers. . . . It is a far cry from John Q. Public finding out how his government works.

WHAT HAPPENED in the 1974 amendments to the Freedom of Information Act is similar to what happened in much of the regulatory legislation and rulemaking of that era: an entirely desirable objective was pursued singlemindedly to the exclusion of equally valid competing interests. In the currently favored terminology, a lack of cost-benefit analysis; in more commonsensical terms, a loss of all sense of proportion.

Take, for example, the matter of costs. As noted above, the 1974 amendments were estimated by Congress to cost $100,000 a year. They have in fact cost many millions of dollars —no one knows precisely how much. The main reason is that the amendments forbid the government from charging the requester for the so-called processing costs. Responding to a request generally requires three steps: (1) searching for the requested documents; (2) reviewing or "processing" them to determine whether any of the material they contain is exempt from disclosure, to decide whether the exemption should be asserted, and, if so, to make the line-by-line deletions; and (3) duplicating them. Before 1974, the cost for all of this work was chargeable to the requester; since 1974, step two has been at the government's expense. In many cases, it is the most costly part of the process, often requiring the personal attention of high-level personnel for long periods of time. If, for example, material in an investigative file is requested, someone familiar with the investigation must go through the material line by line to delete those portions, and only those portions, that would disclose a confidential source or come within one of the other specific exceptions to the requirement of disclosure. Moreever, even steps one and three are at the government's expense "where the agency deter-

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mines that waiver or reduction of the fee is in the public interest because furnishing the information can be considered as primarily benefiting the general public." Even where the agency parsimoniously refuses to grant this waiver, the more generous judiciary sometimes mandates it—which happened, for example, in the case of the FOIA request by the Rosenberg children.

The question, of course, is whether this public expense is worth it, bearing in mind that the FOIA requester is not required to have any particular "need to know." The inquiry that creates this expense—perhaps for hundreds of thousands of documents—may be motivated by no more than idle curiosity. The "free lunch" aspect of the FOIA is significant not only because it takes money from the Treasury that could be better spent elsewhere, but also because it brings into the system requests that are not really important enough to be there, crowding the genuinely desirable ones to the end of the line. In the absence of any "need to know" requirement, price is the only device available for rationing these governmental services—and in many cases a price based on search and reproduction costs is simply not adequate.

Other features of the amendments reflect the same unthinking extravagance and disregard of competing priorities. Although federal agencies carry out a great many important activities, rarely does the law impose a specific deadline for agency action. Yet the FOIA requester is entitled by law to get an answer to his request within ten working days—and, if it is denied, to get a ruling on his appeal within another twenty. (There is a provision for an additional ten days "in unusual circumstances.") So the investigative agent who is needed to review a file must lay aside his other work and undertake that task as his top priority.

It is also rare that a federal official *must* be subjected to a disciplinary investigation—even for malicious baby-snatching under color of law, much less mere negligence. But if he should happen to trifle with an FOIA request, stand back! In a provision unique in the United States Code, the 1974 amendments specify that whenever a court considering an appeal from an FOIA denial

> issues a written finding that the circumstances . . . raise questions whether agency personnel acted arbitrarily or capriciously with respect to the withholding, the Civil Service Commission [now the Special Counsel of the Merit Systems Protection Board] shall promptly initiate a proceeding to determine whether disciplinary action is warranted against the officer or employee who was primarily responsible for the withholding.

In the courts, the statute provides that FOIA appeals shall "take precedence on the docket over all cases and shall be assigned for hearing and trial or for argument at the earliest practicable date and expedited in every way." (There is an exception to this preferential treatment for "cases the court considers of greater importance.") And if the requester taking the agency to court "has substantially prevailed," the court is authorized to make the government pay his attorney fees and litigation costs. One would have thought it infinitely more important to pay the attorney fees and litigation costs of persons who are erroneously or even frivolously prosecuted by the government — but of course the law makes no provision for such payment.

The preferred status of the FOIA requester in the courts is also evident in the standard of review. If a federal agency assesses a penalty against you or revokes a certificate that is necessary for your livelihood, it will do you no good to persuade a judge that the agency is probably wrong. The courts cannot reverse the agency merely because they disagree with its assessment of the facts. They can do so only when there is a lack of "substantial evidence" to support its finding. If, however, an agency denies a freedom of information request, shazam!—the full force of the Third Branch of government is summoned to the wronged party's assistance. The denial is subject to *de novo* review—which means that the court will examine the records on its own and come to its own independent decision. And whereas the general rule is that the citizen appealing to the courts must show that the agency acted improperly, in the case of an FOIA denial "the burden is on the agency to sustain its action."

THE FOREGOING DEFECTS (and others could be added) might not be defects in the best of all possible worlds. They are foolish extravagances only because we do not have an unlimited

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amount of federal money to spend, an unlimited number of agency employees to assign, an unlimited number of judges to hear and decide cases. We must, alas, set some priorities—and unless the world is mad the usual Freedom of Information Act request should not be high on the list.

Some other effects of the 1974 amendments, however, would be malignant even in a world without shortages. Prominent in this category is the provision which requires the courts to determine (again *de novo*) the propriety of classification of documents on the grounds of national security or foreign affairs. What is needful for our national defense and what will impair the conduct of our foreign affairs are questions of the sort that the courts will avoid—on the basis of the "political question" doctrine—even when they arise in the context of the most significant civil and criminal litigation. Imagine pushing the courts into such inquiries for the purpose of ruling on an FOIA request! This disposition appears even more incredible if one compares it with the provisions of the Foreign Intelligence Surveillance Act. There, for the much more compelling purpose of determining whether secret electronic surveillance will be allowed, the court must accept the certification of a high-level executive official that the information sought is necessary to the national defense or the conduct of foreign affairs unless, on the basis of the accompanying data, that certification is "clearly erroneous."

But the most ironic absolute defect of the '74 amendments was perhaps unintended at the time and seems to have gone virtually unnoticed since. The amendments have significantly reduced the privacy, and hence the autonomy, of all our nongovernmental institutions—corporations, labor unions, universities, churches, political and social clubs—all those private associations that form, as Tocqueville observed, diverse centers of power apart from what would otherwise be the all-powerful democratic state. Some of the activities of these associations should be open to public scrutiny, and prior to 1974 Congress made that judgment on a relatively specific basis, in enacting such disclosure statutes as the Securities Exchange Act, the Public Utility Holding Company Act, and the Labor-Management Reporting and Disclosure Act. Of course, in addition to those particular activities of private institutions that require *publication*, virtually all activities of private institutions may be subjected to *governmental investigation*—and increasingly are, to ensure compliance with the innumerable requirements of federal laws and regulations. By and large, it has been left to the agencies to determine when investigation is appropriate, and the courts have been most liberal in sustaining investigative authority.

The effect of the 1974 amendments to the Freedom of Information Act was to eliminate the distinction between investigation and publication. The "investigative files" exemption in the original act was narrowed so as to permit withholding of documents acquired or produced in a law enforcement investigation only if disclosure would cause specific damage to the investigative process or to particular private interests (for example, reveal the identity of a confidential source). The way things now work, the government may obtain almost anything in the course of an investigation; and once the investigation is completed the public (or, more specifically, the opponents or competitors of the investigated institution) may obtain all that the investigative file contains, unless one of a few narrow exemptions applies. There is an exemption (though the agency has discretion not to invoke it) for confidential commercial information. But there is none that protects an institution's consultative and deliberative processes—the minutes of a university's faculty meetings, for example. It is noteworthy that internal consultation and advice within the government itself is exempted from disclosure since, as the 1966 House Committee Report explained, "a full and frank exchange of opinions would be impossible if all internal communications were made public." But no such exemption exists for the internal communications of private organizations that come into the government's hands. In other words,

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legislation that was supposed to lay bare the workings of government is in fact more protective of the privacy needs of government than of private institutions.

THERE SEEMS LITTLE HOPE, however, that these absolute defects of the Freedom of Information Act, much less its mere extravagances, will be corrected. And once the fundamentally flawed

. . . once the fundamentally flawed premises of the '74 amendments are accepted, as they have been, all efforts at even minor reform take on an Alice-in-Wonderland air.

premises of the '74 amendments are accepted, as they have been, all efforts at even minor reform take on an Alice-in-Wonderland air. For example: The government is concerned about use of the Freedom of Information Act as a weapon in litigation. Requests by a litigant for judicially compelled production of documents from the opposing party's files (so-called discovery requests) can be kept within reasonable bounds by the court itself. But when the government is the adversary, there no longer is any need to use the judicial discovery mechanism. An FOIA request can be as wide as the great outdoors; and the government must produce the information within ten working days —or, as a practical matter, within such longer period as the requester is willing to negotiate. It is not only a good way to get scads of useful information; it is also a means of keeping the government's litigation team busy reviewing carloads of documents instead of tending to the trial of the case. The story is told of a criminal defense lawyer who negotiated a favorable plea for his client by filing an onerous FOIA request that would have taken weeks of the U.S. attorney's time. And why not? Anyone can file such a request, and surely the attorney is obliged to use all lawful means to serve the interest of his client.

Well, the government's proposed solution for this problem is to forbid FOIA requests by litigants once litigation has commenced. Apart from the practical difficulty of enforcing such a ban, consider the Mad Hatter result it would produce: Absolutely anybody in the world (the FOIA requester does not, by the way, have to be a U.S. citizen) would be able to put the government through the inordinate trouble and expense of the FOIA process *except*—you guessed it—the person most legitimately interested in the requested information.

The defects of the Freedom of Information Act cannot be cured as long as we are dominated by the obsession that gave them birth—that the first line of defense against an arbitrary executive is do-it-yourself oversight by the public and its surrogate, the press. On that assumption, the FOIA's excesses are not defects at all, but merely the necessary price for our freedoms. It is a romantic notion, but the facts simply do not bear it out. The major exposés of recent times, from CIA mail openings to Watergate to the FBI COINTELPRO operations, owe virtually nothing to the FOIA but are primarily the product of the institutionalized checks and balances within our system of representative democracy. This is not to say that public access to government information has no useful role—only that it is not the ultimate guarantee of responsible government, justifying the sweeping aside of all other public and private interests at the mere invocation of the magical words "freedom of information."

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It is possible to save the desirable features of the FOIA—and even to give it teeth it did not have before 1974—without going to absurd extremes. But don't hold your breath. As the legislative debate is now shaping up, a few minor though worthwhile changes may be made, such as exemption of CIA case files. But the basically unsound judgments of the '74 amendments are probably part of the permanent legacy of Watergate. We need not, however, admire the emperor's clothes. ■

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IS REGULATORY RELIEF ENOUGH?

Marvin H. Kosters and Jeffrey A. Eisenach

A PRONOUNCED DEPARTURE from the regulatory policies and practices of the past decade was certainly a reasonable expectation when the Reagan administration took office in January 1981. And indeed the administration took a number of strong actions in its early months. Since then, however, the momentum appears to have been lost. What seemed to be a clear sense of direction has given way to a disappointing drift. And in some instances reforms introduced earlier have been at least partially reversed.

Are these impressions accurate? Has what promised to be a vigorous and aggressive program of regulatory reform floundered under efforts to put it into practice? The answers are not as clear-cut as either some recent criticisms or the administration's own assessment might suggest.

Part of the difficulty in judging what has been achieved stems from the very scope and diversity of regulation itself. Unless carefully chosen to exhibit a common theme, a set of particular regulatory initiatives is typically so heterogeneous that it suggests either a piecemeal and opportunistic approach to reform or a lack of coherent direction. Another part of the difficulty is that it is far easier to state reform objectives than it is to apply realistic criteria to actual regulatory developments.

Murray Weidenbaum has provided a simple and straightforward statement of objectives: "(1) doing a better job of achieving regulatory goals while (2) reducing regulatory burdens" (*Regulation*, November/December 1980). For some areas of regulation, the best way to attain these objectives is to dismantle regulatory structures and rely on competition. For other areas, however, some form of regulation is called for. In those cases, agencies should avoid regulations that are either inefficient or too costly compared to the benefits they achieve, while establishing policies to deal more effectively and efficiently with the problems that gave rise to the regulatory programs in the first place. The goal of regulatory reform is the same in both areas—to achieve improved overall economic efficiency.

These criteria, of course, do not provide a simple yardstick by which to judge the Reagan program. More important, perhaps, the objectives themselves set a very ambitious and de-

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manding standard for assessing regulatory actions. It would hardly be reasonable to expect them to be realized fully by any administration, even over its full term. Moreover, progress can be sustained only to the extent that broad political support can be organized and maintained. Consequently, an assessment of regulatory developments during President Reagan's first year must also take into account whether his overall policy approach promises to build support for continued reform.

Early Initiatives

The centerpiece of the Reagan administration's regulatory reform efforts has been the Presidential Task Force on Regulatory Relief, coupled with the procedures for coordination and review of regulatory policy established under Executive Order 12291. The designation of Vice President Bush as chairman of the task force gave visibility to its actions, and the review procedures provided a vehicle for dealing with specific proposals and regulations. The perception created early in the year that the White House was embarking on an aggressive program of regulatory reform is largely attributable to the activities of the task force. Indeed, from the standpoint of regulatory reform, the administration got off to a flying start. It announced the task force on its second day in office, established a sixty-day freeze on "midnight regulations" in its second week, and issued the executive order in mid-February. And the task force released its first "hit list" of existing regulations scheduled for review in March, following this up in April with a list of proposed regulatory changes for providing relief to the auto industry.

Regulatory reform initiatives during the early months of the administration were not limited, of course, to the task force. Late in January, the President removed domestic crude oil and gasoline price ceilings. He also abolished the Council on Wage and Price Stability and its wage and price monitoring program. Several agencies announced changes in existing and proposed regulations. The Department of Education withdrew its much-publicized "bilingual education" rules, the National Highway Traffic Safety Administration (NHTSA) proposed delay of passive restraint requirements for large cars, the Occupational Safety and Health Administration (OSHA) withdrew its chemical labeling requirements, the Environmental Protection Agency (EPA) said it would reconsider garbage truck noise standards, and the Department of the Interior expressed its intent to modify strip-mining regulations. In making choices for regulatory appointments, the administration emphasized it would select officials with consistent views who could work as a team committed to reform.

That regulatory reform would take a dramatically different direction than previously followed was the unmistakable impression created by early announcements and actions. Precisely what the character of these new policies would be was less clear.

Regulatory Developments during the Year

In order to assess the main thrusts of the administration's program, it is helpful to examine several key elements of reform policy—regulatory review, budget policies, agency activities, and initiatives to achieve legislative change.

Regulatory Review and Oversight. The coverage and force of the review requirements established by the executive order are probably about as sweeping as was feasible from administrative and legal points of view. The order includes more specific requirements for economic analysis and the weighing of benefits, costs, and alternatives than any of its precursors. Assigning the review function to an OMB office created under the obscure Paperwork Reduction Act of 1980, with the administrator responsible for monitoring both regulation and related paperwork and information collection programs, provides a powerful fulcrum for exerting bureaucratic leverage. Assigning overall responsibility for regulatory policy to the cabinet-level task force raised the character of the process from what might be called guerrilla forays by small bands of economists, frustrating the efforts of heads of agencies and departments, to a broad reform strategy that cabinet-level officials themselves were responsible for carrying out.

Thus, in the new procedures, the Task Force on Regulatory Relief had an important tool for exercising its oversight responsibilities

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on an ongoing basis. But it is easier to count the results than to characterize them.

OMB reviewed more than 2,700 regulations and regulatory proposals between February 17 (when the executive order was signed) and the end of 1981. Almost all of them were approved as submitted; fewer than 5 percent went back to the agencies for more work. Forty-two were designated "major" regulations, and regulatory impact analyses were performed for twenty-one of these.

The executive order covers, of course, not all federal regulations, but only those issued by executive branch agencies. Over half of all regulations issued during the year were immune from review, most of them because they were issued by the independent agencies, but some because they were either emergency regulations or concerned "housekeeping" matters. During the months of March through December, more than 8,000 proposed and final regulations were published in the *Federal Register*, and only about a third of these went through the review process.

Comparison with levels of activity in earlier years clearly indicates that volume declined markedly in 1981 (Table 1)—whether measured in terms of new proposals, final regulations, or pages in the *Federal Register*. Although these data provide insight into the scope of federal regulation, the coverage of the executive order, and the volume of regulation, they tell us little, by themselves, about what effects the review process may have had.

Does the decline reflect success in weeding out regulations that could not withstand careful benefit-cost analysis? Has the process discouraged regulators from forwarding proposals unlikely to survive such scrutiny? Or has activity only been temporarily slowed while agencies get their bearings and work out ways of meeting the newly imposed requirements for review? These questions are not easily answered, even by an examination of the particular regulations that were affected.

Table 1
MEASURES OF REGULATORY ACTIVITY

	Monthly Averages		
	Number of proposed rules	Number of final rules	Pages in *Federal Register*
1977–80	415	613	6,070
1980	446	647	7,251
1981*	276	471	4,856
Percent change, 1980–81	—38	—27	—33

*Data on monthly averages for 1981 exclude January.

Worth Noting—

"There is a famous Sherlock Holmes story in which the decisive clue was the fact that the dog did not bark. Similarly, the most significant development on the regulatory front last year may be the event that did not happen. Not a single major new regulatory law was enacted during the year, nor was a major new regulatory program promulgated by a federal agency. It was the first year in several decades that the federal dog did not bark."

Murray L. Weidenbaum

The process apparently did succeed in screening out regulations with large potential costs and smaller benefits. The fact that examples of such regulations have so far failed to come to public attention lends credence to this judgment. This is a significant achievement. (Murray Weidenbaum makes a similar point—see box.) The review process has placed the onus on agencies to document the impact of their major regulations. And the focusing of public attention on the demonstrated worth of regulations has undoubtedly had a constructive influence, even though there will inevitably be legitimate differences in opinion about whether this has been adequately demonstrated for particular regulations.

Identification of existing regulations for review has been another aspect of the task force's activity. The twenty-seven items on the March 25 "hit list" appear to be significant in terms of their impact on the economy, but otherwise, as with lists of proposed regulations returned to agencies after OMB review,

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it is difficult to discern any salient theme. Judgment on how much improvement might actually be achieved must await the outcome of the reviews and follow-up actions.

Regulations subsequently selected for review are somewhat easier to characterize. These were set forth in two lists—the April 6 list of "Actions to Help the Auto Industry" (involving NHTSA and EPA programs) and the August 12 list of 39 regulatory and paperwork initiatives that was compiled in response to suggestions from state and local government and the private sector. A total of 100 regulations were targeted for review in 1981, and some action had been taken on 38 of them by year end. A third list of existing regulations suggested for review by small business was announced in February 1982.

Many of the federal regulations on these lists affect other units of government rather than the private sector. The credibility of the administration's effort to relieve states and municipalities of regulatory burdens is significantly enhanced by parallel efforts under way. Grant consolidation, for example, could reduce the need for detailed and voluminous federal regulations.

There is also considerable merit in the effort to set priorities by selecting regulations for review because of their costs or their impact on an industry buffeted by competitive pressures. However, announcing the auto industry actions in the midst of the congressional debate on import protection for the beleaguered domestic producers made it difficult to place sufficient emphasis on the importance of determining the individual worth of the regulations involved. The risk that these initiatives would be viewed as intended chiefly to help industry instead of being in the interest of consumers and society as a whole was underscored by the emergence of a voluntary import limitation agreement.

In selecting regulations for review, the task force seems to have focused mainly on providing relief from burdensome requirements—a useful proximate criterion, but one that fails to encompass other dimensions of reform essential for reaching our regulatory goals more effectively. To the extent that selection was not guided by a clear view of goals for reform, the hit lists could not be seen as significant steps in a strategy for achieving those goals and thus could do little to improve public understanding of their merits.

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The Budget. Significant reduction in regulatory agency budgets was clearly a key element of the administration's policies on regulation. President Reagan has succeeded in reversing the steady growth in both budgets and employment that occurred during the Carter administration and in earlier years (Table 2). Perhaps the most striking comparison is that between the Reagan and Carter budgets for fiscal year 1982: regulatory agencies will be approximately 10 percent smaller this year, overall, than they would have been under President Carter's budget. In general, these agencies have absorbed far deeper cuts than has the federal government as a whole.

How these cuts will affect regulatory activity is not entirely clear. In many cases, a strong argument can be made for reducing federal resources devoted to regulatory activities, including resources for developing new regulatory proposals. It should also be recognized, however, that for some important programs the great bulk of the total cost of regulation

Table 2
EMPLOYMENT AND BUDGET TRENDS FOR TWENTY-FOUR REGULATORY AGENCIES

Fiscal Year	Employment	Budget ($ 000s)
1980	72,835	8,828
1981	69,480	8,541
1982	66,782	8,582
1983	64,813	7,632
Percent difference in 1982 proposed budgets:		
Reagan vs. Carter	−10.4	−9.6
Annual average percent change:		
Regulatory agencies		
1977–80	+2.6	+9.9
1980–83	−3.5	−4.3
Total federal government		
1980–83	+0.1	+9.3

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consists of compliance costs imposed on firms, individuals, and state and local governments. Hence, budget cuts could be small and largely symbolic compared to potential off-budget savings to be realized from more efficient and less burdensome regulations. Moreover, analytical resources supported by the federal budget could play an important role in achieving the off-budget savings.

A more immediate effect of the budget reductions is reduced activity at the regulatory agencies. In addition to producing fewer regulatory proposals in 1981 (as shown in Table 1), many agencies have reduced the volume of their enforcement activities—with CPSC recalling fewer products, OSHA making fewer inspections, NHTSA spotlighting fewer defects, EPA bringing fewer enforcement actions, and so on. Rumors of reductions in force have been rampant at the agencies, and there are strong indications at some that actual professional activity has fallen off much more sharply than budget and personnel ceilings. Thus the clear message of budget and personnel policies is a major redirection of federal regulation. For some agencies, however, new directions and goals have been slow to take shape.

The Agencies. However important White House review and analytical guidelines may be, the agencies must necessarily play an active role in establishing the character and direction of policy. This is clear from even a cursory look at the number and variety of regulations published during the year, the proportion not covered by the new oversight process, and the complexity of technical and legal details applicable to the typical regulation. The capabilities of any relatively small oversight staff would be overwhelmed if its responsibilities extended much beyond general review of initiatives set in motion by the agencies. Not only does the ultimate legal responsibility for regulatory decisions rest with the agencies, but their policies have historically played a pivotal role in bringing about reform. In the case of airline deregulation and later the reform of trucking and railroad regulation, for example, the agencies took the lead in developing reform policies, putting them into effect, and explaining them to the Congress and the public.

However important White House review and analytical guidelines may be, the agencies must necessarily play an active role in establishing the character and direction of policy.

Summarizing the role of the agencies is difficult because they are so numerous and so diverse. The opportunity to appoint or designate new agency heads and senior regulatory staff officials is the primary tool for placing the administration's imprint on regulatory policy. In some instances, of course, the influence of a new agency head has been diluted somewhat by the presence of other members on collegial boards or commissions, and in others new appointees were chosen and confirmed only after considerable delay. Development and explanation of new agency goals may have lagged executive branch policies and review procedures for these reasons.

Partly reflecting budget policy and White House review policies, the dominant thrust of agency activities has been to cut back the momentum of regulation. In addition to delaying or withdrawing proposals for review, agencies have removed a number of initiatives from their agendas. Examples include passive restraint requirements for autos (NHTSA), the cereals case and children's advertising (FTC), the IBM and AT&T cases (Antitrust Division, Department of Justice), and public transportation access requirements for the handicapped (Department of Transportation). Agencies have also devoted fewer resources to activities ranging from new regulation development to inspections and enforcement.

In some cases, retrenchment and regulatory moderation have been accompanied by emphasis on new themes. These include increased sympathy for economic development, as illustrated by the Interior Department's strip-mining and oil-leasing policies, and for market development, as illustrated by the CFTC-SEC accord on futures market trading. Efforts to assume a posture emphasizing cooperation instead of confrontation are evident in OSHA's new inspection policies and in CPSC's increased effort to work with industry in setting standards. Relief from costly regulatory requirements, especially under new regula-

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tions, has also been an important, perhaps even predominant, theme.

The review framework established by the executive order bears more directly on social regulation than on economic regulation, in part because the logic of weighing benefits and costs is more closely applicable to the decisions of the social regulatory agencies and in part because more of these agencies are within the executive branch. The change in policy direction has been most pronounced at these agencies.

For economic regulation, the picture is more mixed. Early and complete deregulation of crude oil prices represented a clear departure, but no proposal to remove natural gas price ceilings has been advanced. The thrust of policy in antitrust has clearly shifted toward economic efficiency criteria. In transportation, on the other hand, most observers see more stringent regulation as the predominant direction of change; and in agriculture, finance, and international trade, reform efforts have been less evident than in the social regulatory area. This pattern could be interpreted in various ways. Retrenchment in reforming transportation regulation could be viewed as temporary and selective tacking in order to alleviate short-term adjustment strains; voluntary import agreements could be viewed as necessary to deflect pressures for more draconian measures;

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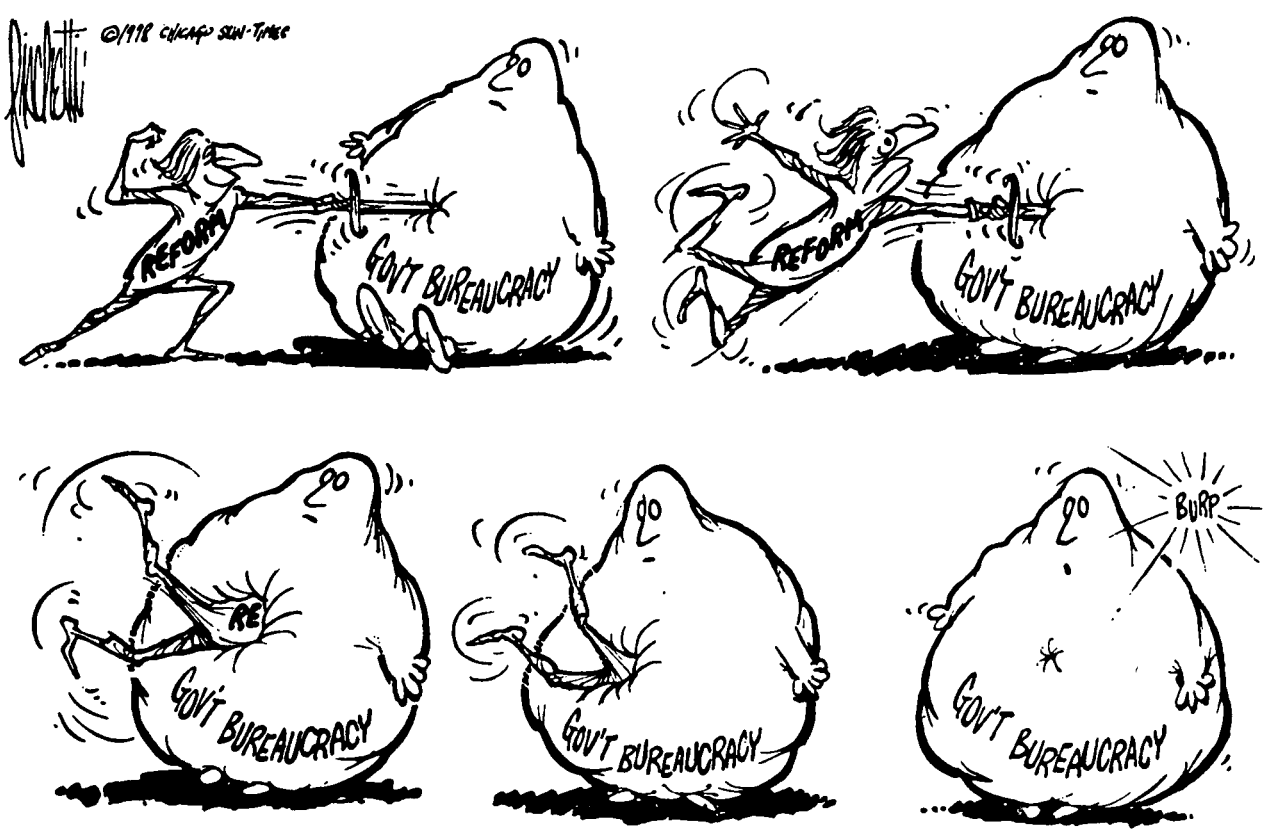
and so on. Nevertheless, even tactical retreat tends to weaken the moral force of a balanced and comprehensive reform program and, in this case, it has led to questions about agency and White House goals for economic regulation.

Only a partial and incomplete picture of administration goals for social regulation can be drawn on the basis of agency actions. What such a picture would *not* contain—costly and burdensome regulations, ambitious new regula-



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tory initiatives, and pursuit of regulatory goals without regard to costs—is in most instances clearer than what it *would* contain. Precisely how agencies propose to do a better job of achieving such broadly supported goals as curbing air and water pollution, reducing the health hazards from exposure to toxic substances, or dealing with hazardous wastes has received less attention. However these goals are pursued, cost-effectiveness analysis and cost-benefit balancing can make a worthwhile contribution, but in many instances the tasks of refining the goals and developing quite different regulatory approaches may be even more critical.

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Legislative Developments. Knowledgeable critics frequently place much of the blame for faulty and inefficient regulation on the basic enabling legislation. In particular, they argue that the statutes establishing the various social regulatory programs provide agencies with little or no scope for taking costs into account. In view of this line of criticism and the administration's emphasis on weighing benefits and costs, it is surprising that the administration's program has not included proposals for significant legislative change.

There are explanations, of course. The primary thrust of the administration's legislative strategy was certainly budget and tax changes, which were sought and enacted. Developing proposals to revise regulatory statutes might have diluted this emphasis. Moreover, it can be argued that urging the agencies to proceed with initiatives within the range of their permissible discretion under existing legislation might be a more effective way of eventually getting desirable changes in the statutes. This is the strategy that was successfully pursued in reforming airline and later trucking regulation.

The case for not adding new items to the agenda for legislative change is stronger, however, than the case for failing to develop specific proposals for legislation that would in any event be on that agenda—for example, the Clean Air Act. It was virtually certain that proposals for major change in the Clean Air Act would be controversial, and it was probably unlikely that the present Congress would enact significant changes. Nevertheless, by failing to develop coherent proposals for at least modest —and much needed—changes, an opportunity was lost for explaining the administration's intentions and goals for environmental regulatory policy. Reports of proposals under consideration aroused controversy, which was not dispelled by either official proposals or the eleven vague "principles" that were eventually announced, leaving the administration's policy intentions uncertain and the prospects for constructive legislative change dimmed.

Thus, the most important opportunity to make a case for legislative change seems to have contributed more to harming the atmosphere for constructive dialogue than to improving prospects for reforming regulation of the environment. Most other legislative activities affecting regulation, such as proposals to abolish the Consumer Product Safety Commission, to "sunset" the Civil Aeronautics Board, and to eliminate the antitrust responsibilities of the Federal Trade Commission were not really critical in terms of overall regulatory policy.

A potentially significant legislative proposal, the omnibus regulatory reform bill (S.1080) passed the Senate unanimously on March 24; the House version (H.R. 746) is awaiting floor action. Among other things, the bill would provide statutory authorization for the review process now carried out under the executive order, and it would extend review authority to the independent regulatory agencies. The administration has kept a low profile on this matter, perhaps in part out of concern that the bill might come out of Congress so encumbered by the legislative veto and other questionable provisions as to be unacceptable.

What Was Achieved?

There is no doubt that the Reagan administration has succeeded in introducing considerable change in regulatory policy. This is a significant accomplishment, particularly in view of the

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traditional resistance of the federal bureaucracy to change. Much of the change has also been constructive—notably, the establishment of White House review of regulatory policy and the development of the analytical guidelines, the slower pace of new regulation, the shift in emphasis from confrontation to cooperation, and the heightened receptivity to new ideas—including those from outside the federal government.

Several seemingly disparate regulatory developments—the benefit-cost framework for review, the cuts in paperwork, budget, and personnel, the review and withdrawal of existing regulations, and the decrease in new proposals—can be viewed as elements in a coherent overall reform approach. Critics of a tight benefit-cost test for regulatory decision making have feared that fewer and less stringent regulations would result. Their fears were well founded. This does not mean, however, that benefit-cost analysis is not the neutral tool that its proponents claim it to be. What it means is that the application of a neutral tool to decision making by single-mission agencies—agencies with narrow legislative mandates that often fail to provide for balancing their particular regulatory goals against all of the other goals of society—will keep some regulations from even being proposed and limit the stringency of those that are issued. Introducing balance is, of course, what regulatory reform is designed to accomplish.

It was to some extent inevitable that the early momentum established by the regulatory reform program would be slowed. The previous administration's regulatory proposals can only be frozen once, and the continued grinding of a review process is less dramatic than its creation. Once the most obvious targets for change have been attacked, the more difficult tasks of maintaining coherence and integrity in regulatory policy and establishing new policy directions must be addressed. A long and complicated war succeeds the initial invasion, and occasional reverses are to be expected.

To continue the analogy, insufficient attention to explaining the strategy and goals of the war has invited the charge of lost momentum. The reform program has taken on a stop-gap character because little further development of its rationale has been communicated to the public as time has passed. Regulatory policy has proceeded as if the invasion were still under way—and perhaps it is. Unfortunately, progress toward durable reform is likely to depend importantly on the administration's ability to make a strong case for its goals as well as its process for achieving them in the many areas affected by regulation.

TO RETURN to Murray Weidenbaum's statement of objectives, the Reagan administration has been more successful in "reducing regulatory burdens" than in "doing a better job of achieving regulatory goals." To be sure, careful benefit-cost analysis contributes to the latter, but because the full rationale has not been well explained, the program has been perceived as primarily regulatory relief. What is needed now is a coordinated White House–agency effort that eschews the piecemeal regulation-by-regulation approach and relates action to a broad strategy for reform. To be seen as elements in such a strategy, agency agendas should be shaped by the contribution they can make to articulating regulatory goals, instead of being driven largely by staff-generated timetables or court-ordered deadlines. Issues on the legislative agenda—clean air regulation (which still must be addressed), along with clean water, natural gas, and financial institution regulation—will provide further opportunities to explain the case for constructive reform. In putting forward a coherent strategy, an effort should be made to maintain a reasonable balance, not only between benefits and costs in social regulatory programs, but also between policies in the social and the economic areas of regulation.

What is needed now is a coordinated White House–agency effort that eschews the piecemeal regulation-by-regulation approach and relates action to a broad strategy for reform.

Regulatory reform was off to an auspicious start in the first part of 1981. Regaining the initiative will undoubtedly be difficult. But it deserves high priority, because it holds the promise of large payoffs in the long run. ■

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Canada's Chicken-and-Egg Problem

The High Cost of Price and Output Controls

Paul K. Gorecki

In the United States, official interest in agricultural regulation—even the relatively obscure part of it called marketing orders (see page 30)—is gathering a head of steam. Last year, at the behest of President Reagan's Task Force on Regulatory Relief, the U.S. Department of Agriculture conducted its most intensive economic review in many years of all federal marketing orders in fruits, vegetables, and related specialty crops. (Milk, the most important commodity subject to such control, was not included.) The review found both good and bad in the orders studied, prompting the department in January to issue guidelines aimed at reducing the inefficiencies that such orders cause.

The more restrictive of the U.S. marketing orders—those for milk (particularly when combined with price supports) and for a few fruits and vegetables—resemble a system of commodity price and output regulation initiated in Canada in the 1930s. This article summarizes Canada's recent experience with that system.

Canada uses supply management boards to control the prices, production levels, and imports of six agricultural commodities—fluid milk, industrial milk (processed into products such as butter, yogurt, and ice cream), eggs, chicken, tobacco, and turkeys. This type of regulation grew rapidly in the 1970s, particularly at the national level. The six commodities accounted for 22 percent of all farm cash receipts in 1979, whereas in 1966 the two commodities subject to such controls (fluid milk and tobacco) accounted for only 10 percent of receipts. Furthermore, recent proposals would extend the controls to beef cattle and potatoes, which represent another 24 percent of farm receipts. These developments have aroused not only controversy within Canada but also the interest of scholars—who have by now produced a considerable body of knowledge on the controls' effect on prices, output, costs, income levels, and efficiency.

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How Marketing Boards Work

Marketing boards are organizations of producers formed to market a particular primary or processed natural product. They are operated under authority delegated by the federal and/or provincial (equivalent to state) governments, and generally are responsible to a supervisory body—for example, at the federal level, the National Farm Products Marketing Council (NFPMC). Such bodies have quite limited

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powers, however, and in any case are dominated by producers. Typically, commodity boards come into existence only after approval by a majority of producers. Like cooperatives, they are run in large part by their memberships; unlike cooperatives, they usually subject all producers of the commodity in a specified area to their rules.

Most marketing boards are intended to give producers bargaining power in negotiating price and other conditions of sale with a small number of buyers. But their powers to coerce the decisions of individual farmers vary considerably. At one extreme, the boards only impose small levies to fund product promotion and development; at the other, they rigidly control price and output. In between are boards with powers to establish prices, but not output, by assuming a selling responsibility or negotiating on behalf of producers. Here I address those boards that exercise the most stringent controls over the economic decisions of the individual producer—setting both the sale price that all producers receive and the specific output (or quota) that each may produce. Boards of this kind are referred to as having supply management powers.

A supply management scheme may be national or provincial in scope. A national scheme is based on an agreement, or marketing plan, between provincial governments (which have power over intraprovincial trade) and the federal government (which has power over interprovincial and international trade). The plan specifies, for the relevant commodity, the quantity that can be produced nationwide and in each of the provinces. The federal board administers the supply management powers—setting prices,[1] marketing the regulated commodity, and so on—while the provincial boards allocate their respective quotas to individual producers within the province and help to enforce the national plan. A provincial scheme differs from a national scheme only in that all supply management powers are exercised by the provincial board. Provincial supply management has developed for fluid milk, because it is perishable, and for tobacco, because its production is concentrated in the province of Ontario.

In administering national or provincial plans, the provincial boards use various control powers such as seizing and disposing of "surplus" supplies and inspecting individual producers to make sure they do not exceed their quotas. There are also import controls, run at the federal level but with the advice and assistance of the national or provincial boards, that buttress the "management" of the domestic market. Indeed, before controls can be placed on imports under the General Agreement on Tariffs and Trade, a supply management scheme must be in place.

In determining prices, supply management boards increasingly make use of cost-based formula pricing. That is, the board commissions periodic surveys of cost for the "average" or "reasonably efficient" or "representative" producer, in order to arrive at a "reasonable" price. Using the formula, prices are changed to reflect changes in interest rates and in such inputs as feed prices. Quotas are set to meet the expected demand at a fixed price. Surpluses are stored or sold on the world market, while shortages are met by drawing on inventories or by purchasing from abroad. The exercise of these price and output powers is exempted from the provisions of Canada's antitrust statute, the Combines Investigation Act.

Income Redistribution and Quota Values

To the extent that a supply management board succeeds in raising the price of its producers' output above their production costs, including normal returns to capital and labor, it creates a stream of returns that is capitalized in the form of a quota value. The quota, in effect, gives the holder the right to sell a specified volume of output through the board, even though the quota might be specified in terms of a particular input (such as the number of laying hens permitted, where eggs are being regulated). The value of the quota is not included in the cost-based price formula. This should theoretically cause quota prices to drop toward zero; since they have not, it can reasonably be deduced that the formula overstates actual costs of production for at least some producers.

There are well-developed markets for the buying and selling of most commodity quotas. Some quotas are freely transferable. Others, however, can only be sold in connection with

[1]This power now exists for eggs and industrial milk and appears to be emerging for chickens and turkeys.

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U.S. Agricultural Marketing Orders

Marketing orders are issued by the U.S. secretary of agriculture at the request of producers. The orders authorize certain restrictions on the quality and quantity of products that can be marketed. These restrictions vary from order to order and may include packaging standards, minimum requirements for grade and size, limits on the amount that can be shipped during certain periods within the marketing season, limits on the amount that can be sold on the fresh market and, in a few cases, limits on the total amount that can be sold at all. The cost of administering the orders is paid by growers and handlers themselves, through assessments. In some cases these fees also finance research and promotion activities.

Each marketing order applies to one commodity grown within a specified geographic area. The order is usually proposed by a producer group, examined at a public hearing, and evaluated by the Agricultural Marketing Service which, on finding the proposal necessary to achieve orderly marketing, recommends it for adoption. The secretary of agriculture, after reviewing objections to the order, submits his final decision to a producer referendum. Two-thirds of the eligible producers, or producers accounting for two-thirds of the total volume, must approve an order before it can take effect. Once it is issued, a marketing order is binding on all growers and handlers of the product in the covered area. The secretary of agriculture may suspend or terminate an order at any time if he finds it is not fulfilling the intent of the act or that a majority of the growers favor ending it.

Marketing orders got their start in the 1930s after voluntary marketing agreement programs failed because of the "free-rider" problem—that is, growers who did not participate in a program could gain its benefits without meeting its restrictions or sharing its costs. The current law governing the orders is the Agricultural Marketing Agreement Act of 1937 (as amended). This law has been strengthened modestly over the years and its coverage has been extended to additional commodities, but its basic provisions have remained unchanged.

Congress provided for marketing orders primarily as a way to ensure orderly marketing conditions and secure parity prices for farmers. ("Parity" occurs when the price of farm commodities has risen as fast as the prices paid by farmers, with reference to prices in a base period.) The act instructs the secretary of agriculture to look out for consumers' interests as well, by raising prices only gradually, by not using marketing orders to maintain prices above parity levels, and by ensuring that the actions are feasible in view of current demand in domestic and foreign markets. In practice, parity prices are seldom attained under marketing orders, and orderly marketing is more commonly cited as their purpose.

Fruit and vegetable marketing orders functioned for more than three decades with relatively little controversy. But during the 1970s, concerns arose about their effects on food prices and availability. On January 25, 1982, the Department of Agriculture, following a study of the marketing orders for fruits, vegetables, and specialty crops, issued a set of guidelines to govern their operation. The guidelines endorse marketing orders as a possible way to stabilize the market for farm products. But they declare that the producer allotment system, a U.S. variation on the Canadian quota system, is "contrary to the general policy of this administration," even though "it does have a statutory basis." Existing allotment programs will be carried out "in a manner that will eliminate barriers to entry." The guidelines also took a mildly skeptical line on such supply management devices as stockpiling, import restrictions, and "shipping holidays."

As of mid-1981, the only marketing orders having the authority to use producer allotments were those covering cranberries, Florida celery, hops, and spearmint oil. Other marketing orders covered citrus fruits (nine orders), potatoes (six orders), peaches (four orders), pears (three orders), grapes, cherries, prunes, onions and tomatoes (two orders each), plums, nectarines, apricots, papayas, melons, avocados, olives, lettuce, dates, raisins, almonds, walnuts and filberts (one order each). [See "Dispatch from the Nut Wars," Perspectives, *Regulation*, January/February 1982.]

This summary is adapted from Department of Agriculture, *Review of Federal Marketing Orders for Fruits, Vegetables, and Specialty Crops: Economic Efficiency and Welfare Implications*, October 15, 1981, and *Guidelines for Fruit, Vegetable, and Specialty Crop Marketing Orders*, January 25, 1982.

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AGGREGATE QUOTA VALUE OF SUPPLY-MANAGED COMMODITIES IN CANADA, MID-1978

Commodity	Aggregate Quota Value ($ millions)
Fluid milk	637.4
Industrial milk	609.4
Eggs	197.4
Chickens	304.4
Turkeys	100.4
Tobacco	247.3
TOTAL	2,043.3

Source: G. Brinkman, *Farm Incomes in Canada* (Ottawa: Economic Council of Canada/Institute for Research on Public Policy, 1981), Table 3-21.

the specific farms to which they apply, or can only be sold to a farmer whose total quota, after the transfer, does not exceed a specified maximum. Despite these limitations, quotas usually command a substantial price, suggesting that consumers of the regulated product are paying more than the actual cost of production.

Quota values represent substantial sums.[2] Some indication of how large they were in mid-1978 is found in the table below. Moreover, in the 1970s these values often rose faster than the consumer price index. For example, from 1972 to 1977, the price of quotas for fluid milk, eggs, chicken, and turkeys in British Columbia increased by 97, 129, 57 and at least 100 percent, respectively, while the CPI increased by 53 percent. Between mid-1978 and 1980 the aggregate value of quotas in Canada increased from $2.0 billion to about $3.0 billion, and aggregate egg and chicken quota values increased from $197 million and $304 million, respectively, to $282 million and $441 million.

Another way to look at quotas is to compute the annual income stream that they provide to a typical producer, by multiplying the producer's quota value by an appropriate interest rate. The resulting figure represents income producers receive over and above what they would have received if commodity prices had reflected true social value as measured by the market.

- In early 1980, the quota held by the average egg producer was worth $123,000 and that of the chicken producer was worth $193,000. This implied annual income streams of $20,000 and $31,000, respectively, per producer.
- In 1977 the average tobacco grower in Ontario held a quota worth $84,000, with an implied annual income stream of $7,500.
- In early 1981, the quota in Ontario for a single farmer was worth $100,000 for milk, $500,000 for eggs, $250,000 for turkeys, and $500,000 for chickens, with implied annual incomes of $15,000, $75,000, $38,000, and $75,000 respectively.

These figures suggest that established owners who receive their quotas for free when a supply management system is created (or do not have to pay when the quota is increased) benefit substantially from the system. However, the would-be producer, who must buy the right to operate from an established producer, faces a significant cost of entry over and above the cost of buying, equipping, and stocking a farm.

Supply management raises prices, partly by creating inefficiencies (discussed below) and partly because of the monopoly power reflected in the value of quotas. However, because there are many consumers and few producers, the amount each consumer pays in higher prices is small compared with the benefits received by each producer. For example, the annual cost of quotas to the average Canadian family in 1980 was $11 for chicken and $8 for eggs—amounting to 9¢ a pound for chicken and 13¢ a dozen for eggs.

In effect, the producer-dominated supply management boards impose a small per unit tax on consumers in order to yield substantial benefits to the producer. It is, therefore, not surprising that an NFPMC investigation into the egg board concluded that, despite the board's statutory duty to take consumer interests into account, its major policy documents "provided evidence of a total emphasis on producer matters." A recent formal inquiry,

... the annual cost of quotas to the average Canadian family in 1980 was $11 for chicken and $8 for eggs.... In effect, [the] boards impose a small per unit tax on consumers in order to yield substantial benefits to the producer.

[2]Estimates of quota values and the implied income from them are drawn from a variety of sources and are based on different approaches and methodologies, and hence may not always be exactly comparable.

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headed by Justice H. Gibson, into the administration of industrial milk policy likewise concluded that "the interests of the consumer do not appear to have been a substantial concern...."

Efficiency Considerations

As noted, supply management boards, by introducing quotas and attaching various restrictions to their use, not only redistribute income from consumers to producers but also reduce the efficiency with which agricultural goods are produced. In other words, too many resources —land, labor, and capital—are used to produce a given level of output. Furthermore, innovation may be discouraged.

An important source of potential inefficiency is the allocation of Canada-wide quotas among the provinces by nonmarket methods. The initial distribution of the quota for a commodity is usually based on each province's previous output of that commodity. A 1980 federal Department of Justice publication *(Securing the Canadian Economic Union in the Constitution)* outlined some of the resulting problems:

> [T]here is considerable reluctance to reallocate market shares, and even more reluctance to base that reallocation on the principles of comparative advantage.
>
> Some provinces that import under supply management arrangements feel that they should have preferred access in their local market. This would further impede interprovincial trade.
>
> Since market shares are negotiated for one commodity only, these arrangements do not allow the advantages of specialization and trade to be fully captured.

Given such impediments to resource mobility, the sale price of quotas is likely to differ more and more from one province to another as population movements continue and factor prices change. This of course would be a signal of geographic inefficiency. One recent estimate (by the Department of Finance) suggests that $4 million could be saved annually in resources if industrial milk quotas were tradeable across provincial boundaries. Furthermore, such costs are likely to increase over time as the allocations made in the 1970s become less and less realistic.

Inefficiency can also arise when supply management boards impose constraints on quota use that discourage producers from employing the most efficient combination of labor and capital. This occurs in a variety of ways. Quotas are often tied to an input rather than an output, where the former is easier to administer. Controlling the number of eggs is much more difficult than counting laying hens. Quotas on a single input, however, lead producers to intensify their use of other inputs. Thus, when tobacco quotas were specified in terms of acreages, producers boosted their output per acre, even though this reduced quality. Tobacco buyers then requested that the quota be specified in pounds of tobacco. In egg supply management, the number of laying hens is the variable under control, and producers naturally try to increase the number of eggs per hen. The result is periodic overproduction, with the surpluses dumped on world markets, flock sizes reduced, and egg barns left empty.

In egg supply management, the number of laying hens is the variable under control, and producers naturally try to increase the number of eggs per hen. The result is periodic overproduction....

Another obvious curb on efficiency is the frequent practice, usually provincial, of setting ceilings on the amount of quota that a single producer can hold. For example, the maximum chicken quota in British Columbia in 1977 was 51,400 chickens per eleven-week cycle. A B.C. legislative committee criticized this limit in its 1978 report:

> There is evidence to suggest that the optimal size is far larger. . . . In the United States, for example, family farms producing 100,000 or more birds per cycle are common. In addition, both research and the U.S. experience confirms returns to scale continue beyond 200,000 birds per cycle.

By 1980, British Columbia had raised its maximum only to 56,000—while Ontario and Quebec, accounting together for 68 percent of the Canada-wide quota, had upper limits of 75,000 and 100,000, respectively. Although the declared

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reason for the limits is to preserve the family farm, some critics claim they are chiefly designed to keep quota value from going even higher, and attracting further public attention and criticism.

Yet another restriction, with a motivation similar to quota ceilings, is to attach the quota to a specific asset, usually the farm, so that one cannot be transferred without the other. This too prevents economies of scale from being fully realized. The availability of such economies is evidenced by farmer attempts, through bogus land deals and other legal transactions, to transfer quota independently of their farms. In one recent Ontario case, a farmer tried to increase his chicken quota holdings through ploys of this kind, hoping to fill up a half-empty barn.

The combination of the latter two restrictions—quota ceilings and the tying of quota to a particular farm—seems to have led to major inefficiencies. One report (by T. Borcherding, with G. W. Dorosh) compared 1975 egg production in British Columbia and in neighboring Washington state, which had no such controls:

> In Washington state about 66 percent of annual egg production is derived from farms having flocks larger than 50,000 birds, in B.C. only 5 percent. . . . More importantly, in B.C. 66 percent of egg production is derived from flocks which range in size from 10,000 to 50,000 birds. According to a report done for the Canadian Egg Marketing Agency, this is the least cost efficient production range. Both smaller flocks (12,000 birds or less) and larger flocks (more than 48,000 birds) experience lower production costs. The mid-range farms, so prevalent in B.C., experienced costs 8 percent higher than small farms and 16 percent higher than large farms.

No overall measure of all of these inefficiencies is available, but they are likely to be significant.

Quotas and the inefficiencies associated with them mean higher product prices, which means in turn that imports of the quota-regulated product will have to be controlled. Moreover, if that product is an important ingredient in a processed commodity, then the processing industry may itself become internationally uncompetitive and demand import controls for its products. This has occurred in the case of industrial milk: products such as butter, yogurt, and some types of cheese are all now subject to stringent import controls. A similar pattern may be expected to develop for processed products made from chicken, eggs, and other commodities subject to supply management.

. . . if [a quota-controlled] product is an important ingredient in a processed commodity, then the processing industry may itself become internationally uncompetitive and demand import controls for its products.

The supporters of supply management say it improves efficiency by reducing uncertainty about future prices and planned production levels, and thus bringing about "better" investment decisions and lower costs. However, certainty is an economic good, like any other, and buying too much of it is inefficient. The available evidence on the effect of supply management on price certainty is sketchy. The study comparing egg prices in British Columbia and in Washington state found that supply management narrowed price dispersion. On the other hand, a 1978 study that examined variability in output, producer and consumer prices, and industry gross revenues for tobacco, chickens, eggs, and turkeys in Ontario (one of the two biggest provincial markets) concluded: "the only verdict which is supportable at this stage is that found in Scottish jurisprudence, 'not proven.' "

In sum, the evidence on efficiency, although not as unambiguous and quantifiable as that for income redistribution, suggests that substantial inefficiencies have arisen, some of which are likely to increase over time, while any improvement in stability that may have occurred is of questionable economic value.

Goals and Results

A major objective of supply management marketing boards—some would say the only valid one—is to provide adequate and stable incomes for producers at a rate of return on farmland, equipment, and labor broadly comparable with

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that earned in other sectors of the economy. Two questions need to be asked. Have the boards actually raised incomes, either permanently or temporarily? If so, how have the gains been distributed?

Under supply management schemes, the regulated price is set higher than the unregulated price would be. What happens then, as we have seen, is that the difference between the regulated and unregulated price is capitalized in the value of the quota—and those who initially received their quotas "free" realize a capital gain when they sell them. Subsequent buyers of quotas in effect buy the right to produce the regulated product. Thereafter the market operates as usual, and the new entrant earns a competitive rate of return on *all* assets, including the quota. Consequently, supply management results in a one-time step up in income for established producers.

The new entrant—who, since his seller has made off with the monopoly profits attributable to the quota system, is now in about the same economic position as an unsubsidized producer—can be expected to press the board to widen the difference between the regulated and the market price. If he is successful, the value of his quota will of course increase at least until prices reach the monopoly optimum (that is, the price at which aggregate quota value is maximized). Unfortunately no studies have attempted to determine how close prices are to this peak.[3]

The second question is—who benefits? For the larger, more efficient producers, the subsidy takes the form of a "rent," because their costs are low enough that they would be in business anyway. For the smaller farmers, the effect of the subsidy is to enable them to stay in business, because their costs are above the unregulated price but below the regulated price. The evidence indicates that commercial farmers hold the vast majority of the quotas. By and large, they earn adequate rates of return on their assets and adequate incomes. The so-called income problem is confined mainly to the remaining quota holders who, while numerous, hold relatively small amounts of quota in all. Thus, even if supporting the incomes of small farmers is a valid objective of farm policy, supply management is an inappropriate means, since its benefits accrue largely to commercial producers.

Even if supporting the incomes of small farmers is a valid objective of farm policy, supply management is an inappropriate means, since its benefits accrue largely to commercial producers.

Prospects for Reform

Our analysis suggests that supply management is seriously flawed and that its flaws are likely to increase over time. Clearly, a shift to more appropriate policies is in order. The income problem, which principally involves relatively small farmers, could be better handled by direct income support. The instability problem could be addressed by extending Canada's existing stabilization programs (for example, the Agricultural Stabilization Act or the Western Grain Stabilization Act) to the six supply-managed commodities and by establishing, where possible, futures markets and forward contracts.

Unfortunately, regulatory programs, once started, are hard to stop. In the case at hand, abolishing supply management would inflict large losses on persons who bought their quotas in good faith. Quotas are often a big part of a farmer's total capital investment—for example, between 37 and 50 percent on average in 1977 for producers of fluid milk, eggs, and chickens in British Columbia. Thus the federal and provincial governments, unless they are prepared to break faith with the quota holders or to spend approximately $3 billion to buy out their quotas, are locked into supply management schemes that, with the passage of time, benefit nobody and disadvantage many. The current federal minister of agriculture is well

[3] In the case of industrial milk, a very large subsidy, which encourages output, substantially offsets the effect of supply management. Indeed, the quota serves not only as a right to produce and market a certain volume of milk, but also as a ticket to the subsidy. As a result, the implied average annual income stream from the quota per producer is much smaller than for other supply-managed commodities—under $1,000 in 1977. Nevertheless, the large number of producers—66,766 in 1977–78—results in the large absolute aggregate quota value recorded in the table.

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aware of the problem. When speaking of the chicken quotas in a 1980 speech, he remarked:

> We have been fooling around with this question of quota values for too long. We all know that the answer will in some cases mean reducing the wealth of the people who hold quota, and that is a difficult thing to do politically. Nonetheless, I fear that it has gotten out of hand.

Not only would it be costly to end supply management programs, but there is a further difficulty: the most obvious alternative—subsidizing all producers directly for each unit of output—is not attractive politically. Under this alternative all taxpayers, rather than just consumers of eggs, milk, turkeys, chicken, and tobacco, would subsidize the producer. The disadvantages for both politicians and producers are readily apparent.

One is that the federal and several of the provincial governments are too short of funds now, and were during much of the 1970s, to make the annual payments of several hundred million dollars implied by quota values of $3 billion. Hence the increasing reliance on supply management in recent years. The industrial milk case dramatically illustrates the point. From fiscal year 1966 to fiscal year 1975, subsidies increased from $19 million to $251 million, or from 7 percent of all federal farm spending to 21 percent. Then in 1975 the federal government announced its Long Term Dairy Policy, which froze total subsidy payments at 1975 levels and began a system of supply management. In other words, confronted with rapidly escalating budget expenditures for the industrial milk program, Ottawa simply switched to the off-budget approach of supply management, so that the consumer, rather then the Exchequer, bore the brunt of the policy.

... confronted with rapidly escalating budget expenditures for the industrial milk program, Ottawa simply switched to the off-budget approach of supply management, so that the consumer, rather than the Exchequer, bore the brunt of the policy.

There are other factors that favor the use of supply management. Producers, fearing the market power of the food processors who buy their products, are inclined to rationalize supply management as a way to restore a fair balance of power and permit them a degree of control over the vicissitudes of the market. Many of the same producers, by contrast, would view direct cash subsidies as a form of welfare and hence repugnant. And politicians, worried that the direct transfers would be very large, highly visible, and perhaps difficult to justify to the public, find supply management attractive because its costs are largely hidden. From a political point of view, then, supply management has much to recommend it to both producer and politician.

The same reason that explains why reform is difficult to achieve helps to explain why the situation may actually get worse. The Standing Committee on Agriculture of the Senate is seriously considering the question of extending the quota system to beef cattle, as the minister of agriculture favors, while a board with just short of supply management powers will soon be created for potatoes. These commodities would probably be much harder to handle than the six already covered—beef cattle because of the integrated nature of the North American market, the long production cycle, and the diverse interests of the producers who would be subjected to the system, and potatoes because of the great variation in yields due to weather conditions. Furthermore, with Canadian agriculture increasingly controlled by a series of commodity cartels, another development bears watching: Parliament currently has before it proposals for a government-run Canadian Agricultural Export Corporation authorized to use "its financial strength" to help meet foreign competition (to subsidize exports), to "facilitate domestic production," and to act as agent for the government in state-to-state deals.

Yet, although the prospects for reform are not bright, there is some movement. In 1978 the federal and provincial governments were concerned enough about the general question of regulation in the economy to refer the matter to the Economic Council of Canada, an independent body that advises the government (and is composed of people drawn from labor, business, universities, agriculture, and consumer groups). In its final report of June 1981, the council made some modest recommendations. The government, it said, should be cau-

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tious about creating new supply management boards, should expand the output permitted under quotas so that prices and quota values would fall, should make quotas freely transferable (eventually throughout Canada), should relax restrictions that damage efficiency, should introduce separate policies aimed at the problem of low and unstable incomes, and should widen the membership of the supervisory councils. Farm groups, supply management boards, and the federal minister of agriculture strongly oppose the recommendations, while food processors support them.

The president of the Treasury Board (an important post in the Canadian government) has been charged by the Prime Minister with coordinating the selective deregulation of industries and activities. It will be difficult. Producers naturally fear they would lose more than they would gain, while consumers who pay the tab are not aware of its size. But if those who are interested in consumer welfare and economic efficiency come to understand the implications of the system, reform may be possible. In any event, Canada's experience with supply management in agriculture provides those who are concerned about U.S. marketing orders with evidence of the adverse economic consequences of greater regulation. ■

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New York City Looks at Taxi Regulation

(Continued from page 13)

ual cabs has virtually broken down with the rise of "mini-fleets." By law, 4,969 medallions must be owned by individuals, and the other 6,818 by fleets of more than one vehicle. This division was originally meant to keep fleets from "taking over" the whole industry, but in recent years the trend has been in the other direction, because individual cabs, generally with non-union drivers, have lower costs than the large unionized fleets. An individual medallion can sell for $10,000 more than a fleet medallion—$60,000 versus $50,000. The market has now found a way around the legal barrier, at least in part. During the 1970s, about 4,700 of the so-called fleet medallions were transferred to mini-fleets —corporations that generally own two medallions and have two corporate owners. In some instances the two owners never even meet each other, the whole transaction being arranged by a medallion broker.

Medallion brokers also perform various other tasks for cab owners, such as arranging bank loans and filing necessary papers with the authorities. In doing so, these brokers have attracted the unfavorable attention of the TLC, which has repeatedly supported unsuccessful attempts in the City Council to bring them under TLC licensing and regulation. The mayoral panel endorsed such regulation, explaining that brokers should, for example, be required "to explain to a medallion purchaser the nature and public service obligations of the medallion."

In some other ways, too, the panel would increase municipal involvement in the industry. It recommends that the city set up its own site for taxi vehicle inspections, which are now done at private garages and meter shops, and it proposes that the city start up a New York City Taxi Driving School that all new drivers would be required to attend.

Overall, the panel's work well illustrates the political dilemma posed by long-standing government barriers to entry. The new proposals would appear to ease entry only by slow and uncertain steps, if at all. But so long as the interests of current medallion holders are not to be harmed, it is hard to imagine how any bolder stride could be taken.

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AUTO INSURANCE: THE IRRELEVANCE OF REGULATION

Mark Nadel

LAX AND INCOMPETENT regulation of insurance is taken as an article of faith by many consumer groups. And not without some justification. A 1979 General Accounting Office report found numerous shortcomings in state insurance regulation, especially the absence of systematic procedures for determining whether consumers were being treated properly with regard to claims payments, rates, and protection against unfair discrimination. Insurance companies, on the other hand, say the regulatory system works well except in those few states where a hostile regulatory environment causes rates to be held too low in general or too low for particular groups—young male drivers, for example.

The truth of the situation does not lie in between these two extremes. It lies all over the place. Automobile insurance is at once well regulated, too rigidly regulated, too laxly regulated, and sometimes incompetently regulated. It is all these things because it is regulated almost exclusively by the individual states—with great differences in effectiveness and even in approach.

The issue of the effectiveness of this state-based system has been debated for some time. But there is a more subtle underlying issue here, as in some other areas of regulation—the relevance of regulation as now constituted. Even if the state insurance departments were far more effective in doing the things they are doing, the welfare of consumers probably would not increase noticeably, and the welfare of insurance companies would not decrease noticeably. The fact is, regulators are and always will be largely impotent to deal with many insurance-related problems.

Background

State regulation of insurance first appeared in the mid-nineteenth century and subsequently developed largely as efforts to supervise the

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private rate-fixing agreements that determined prices in the property-casualty field. Much later, with the state regulatory schemes threatened by a 1944 Supreme Court ruling that the sale of property-casualty insurance was subject to federal antitrust law, Congress passed the McCarran-Ferguson Act. It provided an antitrust exemption for the industry's rate-fixing activities to the extent that they were regulated by the states. Today all states have insurance departments. Although these departments have a number of functions including the licensing and financial examination of insurers and the enforcement of trade practice laws, generally their most visible function is to regulate property-casualty insurance rates—particularly automobile.

The fact is, regulators are and always will be largely impotent to deal with many insurance-related problems.

It should be noted that property-casualty insurance, which covers property losses and the insured's liability to others, is very different from life (and health) insurance. The two industries have different actuarial and underwriting societies, different tax and regulatory laws, different sales practices, and so on. They also differ in that rate regulation is much more of an issue with property-casualty insurance than with life insurance (whose rates are generally unregulated).

The original and compelling reason for insurance regulation was the need for guaranteed solvency of insurance companies. An insurance policy is, after all, a contract under which customers pay a small regular predetermined premium in return for compensation should certain misfortunes occur. Thus, the long-term financial viability of the seller is a crucial concern to insurance consumers because what they are buying is reasonable certainty that future claims will be paid.

There was good reason for concern on this score in the late nineteenth century. Fire insurers competed intensely for business which was, in those days, funneled to them by independent insurance agents who frequently set rates and commissions themselves. This situation, coupled with inadequate actuarial systems, led to rates that were too low and eventually to major insolvencies. Following the Chicago fire of 1871 and the Boston fire of 1872, for example, scores of companies went under, leaving policyholders with unpaid claims. The states responded to the problem, first by encouraging insurers to engage in joint noncompetitive rate-setting, usually through private rating bureaus, and ultimately by regulating rates themselves. In short, price regulation—often viewed as a way to hold prices down—came into being in the property-casualty field because of fear that prices would not be high enough.

In the early days, the rating bureaus dominated pricing and, under the cloak of antitrust immunity, operated a cartel largely free of price competition. But today, even in rate-regulating states, this is no longer the case. Now the technique for ensuring solvency is not rate-setting, but a system of financial reserve requirements along with regular audits performed by the state insurance departments.

Do the States Really Regulate Rates?

Nonetheless, rate regulation is still widely practiced in automobile insurance. Currently twenty-nine states regulate the price on automobile insurance directly. Typically, individual insurers or insurers filing jointly through a state's rating bureau submit an application showing the loss experience in each territory and requesting a specified rate adjustment for the coming year. The state insurance department regulates rates either by requiring that they be approved prior to taking effect or by providing a waiting period after which they go into effect unless disapproved. The remaining states, twenty-one in all, use instead a scheme called "competitive rating" or "open competition": an insurer simply informs the insurance department what the rates will be and puts them into effect without having to win approval or acquiescence.

As would be expected, there is wide variety in the methods that price-regulating states employ. In a handful of states, rate regulation is a visible, highly charged, and politicized process. In most, however, it is more routine—and more superficial. Very few states do their own

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actuarial analysis or subject the insurers' rate filings to a penetrating analysis.

A more important circumstance has gone largely unobserved. It is that the actual price paid for insurance is, in practice, not regulated at all. Only the base price of insurance receives regulatory attention. However, the actual price a consumer pays depends on two additional factors. The first is the classification system used to evaluate risk. An insurer applies a set of rating factors—age, sex, use of car—to the consumer, and then multiplies the base price by the appropriate ratings. Thus, the rate applying to a car used for commuting by a male between twenty-five and sixty-four years of age will usually be 1.25 times more than the rate applying to the car used only for pleasure driving. Young males may be charged as much as 3.75 times what other drivers pay. The second important factor that determines price is location or rating territory, with insurance rates varying according to the loss experience of the particular territories. In theory, both of these factors are subject to regulatory approval; in practice, few states scrutinize them.

The base rate approved by regulators is actually a number of base rates—one for each territory. Differences in the loss experience of territories in one year are taken into account the next year, when rates for territories having lower losses than the state average are adjusted downward relative to those with higher losses. State insurance departments do monitor these straightforward adjustments. What they generally do not look at, however, is whether the territories chosen make sense. In other words, is the territory sufficiently homogeneous relative to neighboring territories so that the insureds are being charged a rate that fairly reflects their loss expectancy? Maybe they are; but most state insurance departments do not know and do not endeavor to find out. As a practical matter, this determinant of pricing is not regulated.

Usually there is even less analysis of the personal classification system. In some states, classification has been a lively issue and in four the use of age or sex as a rating characteristic has been banned. However, most states pay scant attention to the classifications. For example, insurance companies are probably on firm ground in charging young drivers far higher premiums. But the size of the differential may be questionable. Studies have shown that using the personal classification system in conjunction with urban territories can result in rates that are much higher than warranted by loss expectancy. On the face of it, insurers have no reason knowingly to overcharge younger drivers, and they are probably right in the classifications that they establish. The prices set by those classifications, however, cannot be termed *regulated,* because only two states ever analyzed the actuarial basis of the insurers' classification plans—Massachusetts and New Jersey—and no state analyzes it regularly. Thus, the price the consumer pays above the base rate is not regulated.

Insurers regard the debate over the personal classification system as really a debate over social regulation or social engineering. And, indeed, an egalitarian impulse may lie behind the desire to do away with actuarially acceptable distinctions. Yet the fact is, those states that have addressed the classification issue may be viewed as the only states that are actually regulating price.

Is Rate Regulation Useful?

More important than the issue of how searchingly the states review insurance rate filings is the question of what difference it makes. Does such regulation really change anything? All the evidence suggests that the answer is no. The GAO study found very little difference in the cost of insurance between states that regulate rates and those that do not. Similar results were obtained by Richard Ippolito in his 1979 study. GAO also found that what differences do exist are only slightly related to various measures of regulatory effort in price-regulating states. Indeed the only factors that seemed to explain differences in insurance costs between states were highly idiosyncratic: New Jersey alone accounted for most of the total national variation among states. Price regulation, viewed nationally, simply does not hold price below the levels that are reached competitively in nonregulated markets. It may, however, reduce the efficiency of the market, as noted by Ippolito as well as by Paul Joskow. That is, in the most rigidly regulated states, regulation prevents the flexibility of rapid price adjustments; and there is some evidence that the "direct writers"—

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firms like State Farm and Allstate which field their own agents instead of using independent agents and which therefore are able to realize marketing efficiencies that permit lower prices —would charge even less in the absence of rate regulation.

Does price regulation at least have the value of making insurance available? While almost all consumers are unhappy about the price of insurance, only a small number are unhappy because they cannot purchase the policy they want. Generally, those who are refused auto insurance are eventually able to buy coverage in a "residual market" of assigned risk plans, reinsurance facilities, and so on—a market mandated and regulated by state law. This residual market, interestingly, is subject to price regulation in all states and, unlike the voluntary market, is a case where regulators hold insurance prices below what would otherwise prevail. As one might expect, coverage in this market is frequently limited, nearly always more expensive, and usually a "loser" for the industry.

Price regulation, viewed nationally, simply does not hold price below the levels that are reached competitively in nonregulated markets.

It is sometimes alleged that "redlining" and other discriminatory underwriting practices limit the coverage available to people in particular parts of urban areas. With few exceptions, insurance departments have not done sufficient investigation to determine whether access to a legally mandated product is or is not being curtailed by clumsy or biased territorial boundaries and underwriting practices.

A great part of the availability problem, however, is caused by regulation itself. The proportion of drivers consigned to assigned risk plans is three times greater in rate-regulated states than in open competition states—a relationship that holds even taking into account the existence of compulsory insurance laws. Much of the difference is accounted for by the very few states that have attempted to keep overall insurance rates below what they would be in an unregulated market. To the extent that rate regulation is not irrelevant, then, it just creates an availability problem.

And no wonder! The structure of the property-casualty industry provides no rationale for price regulation. In auto insurance, the top fifteen companies account for slightly more than half of all business. In 1980 State Farm and Allstate had 17 percent and 11 percent of the business, respectively, but no other firm had more than 5 percent. This national pattern is repeated in most of the states. Moreover, the two industry leaders are generally recognized as forces for price competition. State Farm's meteoric rise, for example, resulted from its undercutting the prices of companies that stuck to the maximum rates set by rating bureaus. Indeed, the dominant factor in the insurance industry today is the continuing growth of the direct writers.

The industry is also characterized by relatively low natural barriers to entry and an absence of significant economies of scale. Indeed, the barriers to competition that do exist are generally imposed—rather than remedied—by regulation. These barriers include "fictitious group" laws prohibiting group auto insurance and "anti-rebate" laws preventing agents from discounting commissions. Thus, by any indicator, the property-casualty insurance industry is favorably structured for competition.

The competitive possibilities of the market have led most students of the field and nearly all insurers to recommend an end to active rate regulation. A Department of Justice study of 1975–76, published by the American Enterprise Institute in 1979, recommended a dual chartering system under which the companies that would like increased freedom on pricing and policy coverages could opt for a federal charter, thereby becoming exempt from state rate regulation. The National Commission for the Review of Antitrust Laws and Procedures recommended in 1979 that the blanket antitrust exemption for insurance be greatly cut back and that competition be encouraged. In late 1980 the National Association of Insurance Commissioners approved a model law for open competition, although the number of states with open competition has not increased much in the last ten years.

One cannot escape the conclusion that the only beneficiaries of rate regulation of auto insurance are the politicians: it enables them to

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curry consumer favor by appearing to hold down rates. There is, moreover, an anomaly in this useless regulation. Oddly, while most states regulate automobile insurance rates, a market with robust competition, few supervise rates in insurance areas that are noncompetitive (such as private medicare supplement insurance), or are characterized by "reverse competition" (competition not for consumers but for agents, as in title insurance), or suffer from a complexity that will probably always defy consumer understanding (as does life insurance).

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Non-Price Regulation Ignored

That rate regulation, as practiced, is overly intrusive is not its only fault. It also distracts attention from other actions that could be taken to correct the market failures that limit the vigor of competition in the insurance market. Chief among these is inadequacy of consumer information—the fact that it is nearly impossible for a layman to know and compare the monetary value of policies. While this problem is particularly serious for life insurance (because there is not any commonly accepted and understood method of cost disclosure in that field), it exists even for standardized auto and homeowners insurance. Here the limitation on consumer information is uncertainty about the quality of the service purchased by the policy —for example, the speed and adequacy of claims settlements. Whereas after-purchase service is a factor that consumers *may* consider when they purchase other products, in insurance it is the *only* factor being purchased. And, as is seldom the case with other products and services, the consumer cannot readily see or evaluate the service until after the purchase. Because the policyholder's claims are so much less frequent than the premium payments, a self-correcting market simply does not exist.

Because of this market failure, consumers are unable to shop intelligently, even though in almost all states some companies offer rates below the state maximums. State insurance departments have at their disposal direct and minimally intrusive means of solving this information problem. For instance, they could produce buying guides setting forth information about prices and company quality. And, with very little effort, they could adopt a perfectly good indicator of company quality, one already available in the regulators' files but inadequately used and publicized. This indicator is the ratio of consumer complaints about a company's services to that company's volume—say, the number of complaints per 1,000 policies or per $1,000,000 of premium volume. Some complaints are no doubt frivolous or unfounded, but there is no reason to think that one company will have a higher proportion of unfounded complaints than another. Thus, if one company consistently has a complaint ratio considerably higher than the others it would tell the prospective policyholder that dealing with that company may be risky, even if it offers lower prices.

Both buying guides and complaint ratios exemplify what *could* be done—but is not. State insurance departments maintain complaint records but do not use them systematically in their own enforcement activities, and rarely make them available to consumers or to the press. Moreover, insurance departments do not monitor systematically the claims activities of insurers, so complaints are pretty much all they have to go on to get a comparative reading on insurers' conduct. In any case, it would be a relatively simple matter (and less expensive than direct regulation) to disseminate regularly the information about prices and complaint ratios that insurance departments already have. This, coupled with removing inefficient regulations, would have the effect of moving in the desirable direction of deregulation while still addressing problems in the market that seem to justify some sort of intervention.

Problems Immune to Insurance Regulation

One must admit, however, that non-price regulation of that sort will not solve the major problems of auto insurance. Are there other issues

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that could be more profitably addressed? The answer is yes—but not by insurance regulators.

Overwhelmingly, the thing that bothers consumers most about auto insurance is its price. A recent Aetna survey found that 71 percent of the public thought that automobile insurance was too expensive, and most regarded the cost as very important to them personally. Despite this, a Lou Harris survey for Sentry Insurance found that most consumers blame not the insurance companies but rather inflation, the high cost of auto repairs, and the large number of claims. These factors do increase premium prices, and the costs involved are impressive. According to the Insurance Information Institute, the economic loss from traffic accidents in the United States was almost $58 billion in 1981. The cost of the major claims components of medical care and auto repairs has been rising faster than the general rate of inflation. Periodically, insurance companies demonstate that the replacement parts of an automobile far exceed the price of the auto itself. The Alliance of American Insurers has reported that the total for all the separate parts of a 1981 Mercury Lynx GL came to $22,561, or $16,057 more than the car's original list price. Auto theft, another element in rising premiums, produced losses of $3.2 billion in 1980, according to FBI records. All of these cost-raising factors—theft, repair costs, and medical costs—are, of course, outside the responsibility of insurance regulators.

Epilogue: An Unintended Impact

Ironically, one of the more significant effects of insurance regulation results from its lack of serious attention to the personal classification system. As the parents of every teenager know, insurance rates rise dramatically as soon as that teenager is added to the family insurance policy. And those rates rise again—as much as 44 percent—when the teenager becomes the owner or principal operator of a car. Surprisingly, in the debate over classification it seems to have escaped notice that those higher rates not only reflect teenagers' higher loss as a group, but provide a financial disincentive against teenagers' owning cars. This suggests that, if rates are excessive due to faulty or inequitable classification, there will be less teenage driving than there otherwise would be. The extent to which the added premium has turned potential teenage car owners into only part-time users of the family car is not known. Arguably, we should expect that just as higher gasoline prices have induced conservation, higher insurance rates will discourage teenage driving—resulting in fewer highway accidents and deaths and providing the unintended benefit of less gasoline consumption.

The irony is that automobile insurance regulation may . . . have its greatest success in what it does not do—regulation of personal classification. Its most expensive activity, rate regulation, is not effective. And . . . regulators are generally powerless to deal with what concerns consumers the most—the factors driving up prices.

The irony is that automobile insurance regulation may thus have its greatest success in what it does not do—regulation of personal classification. Its most expensive activity, rate regulation, is not effective. And as we have seen, regulators are generally powerless to deal with what concerns consumers the most—the factors driving up prices. In sum, then, insurance regulation does what is not needed, does not do what it could do effectively, and cannot do what is needed most. ■

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DOES FATHER KNOW BEST?

The Case of State Employment Agencies

William Papier

UNCLE SAM HAS long assumed a paternal, rather than avuncular, role in his dealings with the fifty states. And no state institution feels the heavy hand of paternal control more than state employment security agencies, which run public employment offices and unemployment insurance programs.

Employment services have long been a state responsibility, and for good reason. Labor market problems vary widely from state to state and from area to area within the same state. During the 1980 recession, for example, Michigan had an average unemployment rate of 12.6, and Wyoming only 3.9 percent. Among California areas, Modesto's rate was 13 percent, while Anaheim's was only 4.3 percent. The nature of local labor market problems varies just as widely.

Except for a few programs like unemployment compensation for federal employees and for ex-servicemen, the programs the state employment security agencies run are creatures of state law. But because of strings attached to federal grants, the state agencies enjoy less autonomy than, say, local government sponsors under the Comprehensive Employment and Training Act (CETA). As federal controls have multiplied, the state agencies have run into problems, and the number of successful placements they make has declined. Federal officials perennially blame the states for the bad results, and federally funded researchers generally support the views of their patrons. The states have not, indeed, been completely blameless. But, as I see it, the biggest share of the blame belongs in Washington.

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THE EMPLOYMENT AND TRAINING ADMINISTRATION (ETA) in the U.S. Department of Labor was previously known as the Manpower Administration, and before that as the Bureau of Employment Security. Still earlier, its functions were carried out by the Social Security Board. Under Title III of the Social Security Act of 1935, the secretary of labor gives money to the state employment security agencies—based on ETA recommendations—for "proper and efficient administration." Because of this lever, the department is and long has been legally empowered to judge what is proper and efficient for the state agencies. Again and again it has used its financial power to mold the state agencies to its liking—and again and again it has been proved wrong by events.

Unemployment Insurance. Although job placement is the older of the two state functions—in Ohio it began in 1890—unemployment insurance is the more visible. When the Social Security Act of 1935 forced the states to adopt unemployment compensation laws, the Social Security Board proceeded to draft model bills for the state legislatures to enact. Among the

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recommended provisions was one requiring that the claimant's base period—the span of prior employment considered in determining eligibility and the amount and duration of benefits—be set at two years. By March 1940 ten states had enacted laws requiring the two-year base period. This meant that each employer in those states had to submit wage records for each of its workers for each calendar quarter, so that the states could calculate the benefits payable to those workers who lost their jobs. As a result, many millions of wage records had to be processed each quarter, only a small fraction of which were ever used. By the end of 1951 every one of the states that had tried the two-year period had thrown in the towel and switched to a one-year base, which drastically reduced paperwork and improved the efficiency with which benefits were calculated.

While the shortened base period was clearly a change for the better, the fact remained that very few of the millions of quarterly wage records still being collected from employers were needed to process claims. Several states, therefore, decided to eliminate wage records entirely in favor of wage reporting "on request": employers would have to submit the necessary data only when workers filed claims. The idea proved so successful that eventually even the federal officials were converted: in January 1951 the Bureau of Employment Security urged all states to dispense with quarterly wage records in favor of on-request reporting systems. A dozen states, including such populous ones as Michigan, New York, and Ohio, now use that system.

The potential paperwork savings are huge. The original system, if in effect nationwide, would call for preparing, submitting, filing, and processing around one hundred million individual wage records each quarter, approximately 90 percent of which would never be used to process claims. On-request reporting does, to be sure, have its own costs: the need to obtain affidavits from some claimants whose employers have gone out of business, the probability that fresher wage data would translate into higher benefits, the absence of a comforting "paper trail," and the initial costs of switching. But by any reasonable standard, the paperwork savings are well worth it.

Now, however, the federal government appears to be changing its mind again. A 1980 study for the National Commission on Unemployment Compensation declared that "a wage record system serves the needs of the UI system best." That may well be so. But what about the needs of everyone else?

State and federal officials have clashed from the early days on the question of how to measure a claimant's "labor force attachment," a factor that determines eligibility for benefits. In the early years federal staffers wanted states to gear their "attachment" test to the claimant's earnings in the base period. Two states, Ohio and Wisconsin, preferred instead a test of "time worked"—the number of weeks a claimant worked in the base period. Time worked, unlike prior earnings, is unaffected by inflation; nearly a quarter of the states now use it. In 1978 a study by a Cambridge research group for the Labor Department confirmed those states' choice, finding time worked "the single best definition of labor force attachment."

Way back in early 1936, when the state of Wisconsin was preparing to issue the very first unemployment benefit check ever paid in this country, the Social Security Board urged it to hand the checks to claimants at local offices. The Wisconsin agency strongly disagreed, and decided instead to mail the checks to claimants at their home addresses. The state's successful experience with that practice subsequently led every one of the other states to follow suit.

For several decades federal officials pressed the states to undertake solvency studies of their unemployment trust funds. They did, some repeatedly. State legislatures were again and again urged to raise enough money to pay adequate benefits and maintain reasonable reserves. Some states, critics warned, were not behaving responsibly: they were eager to raise benefits and loath to raise taxes. (Not unlike the U.S. Congress, they might have added.) But not until relatively recently, mostly during the 1975 and 1980–81 recessions, did a score or so of the state unemployment trust funds go bankrupt. Were the critics' warnings right all along? And if so, why was there no rash of bankruptcies in earlier recessions?

The answer can be found on Capitol Hill, just a block or two away from the Labor Department.

Part of it was Congress's generosity with state money. The Federal-State Extended

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Unemployment Compensation Act of 1970 provided that, during periods of presumed recession, workers who exhausted their unemployment benefits under the regular state laws could draw as many as thirteen more weeks of benefits. Congress agreed to pay half the costs, leaving states to cover the remaining half themselves.

The most important factor in the bankruptcy of state funds, however, was Title XII of the Social Security Act, passed in 1935, which created an interest-free federal loan fund for states whose own funds were depleted. (On April 1, 1982, the fund will begin charging interest of up to 10 percent on new loans.) So long as interest rates were low there was no strong incentive for states to borrow from this fund. But recently, with interest rates running for years at double-digit levels, some states found it highly attractive to deplete their own reserves and borrow federal dollars. Why raise taxes to rebuild their own funds, when they could borrow all they needed from Uncle Sam, for "free"—and pay him off later in cheaper dollars? Now, four states owe more than $1 billion each. The value of forgone interest alone to all borrowing states now exceeds $775 million a year. Taxpayers of the more responsible states are subsidizing those of the less responsible states.

Job Placement. Federal interference with the other major function of state employment agencies, job placement, has been just as disastrous. Although employment offices in smaller cities appear more successful than those in bigger cities, federal advisers have pressed the states to concentrate resources on the latter. Within the larger cities they first urged that local offices be moved from the central areas to the outlying suburban and shopping centers—where the number of jobs was increasing. Then, about two decades ago, they reversed themselves and began pressing local offices to move back to the central cities, because that was where the disadvantaged job-seekers were concentrated.

This approach did not recognize that public employment offices are only referral offices, and cannot make hiring decisions for employers. If they are not suitably located they may not attract either the best candidates or the best job openings.

In the mid-1960s came another major shift. The Labor Department virtually reversed—without authorization from Congress, the state legislatures, or anyone else—the historic policy of public employment offices of referring to employers the best-qualified candidates available. In a policy directive the department defined the experienced candidates, the kind employers wanted, as "job ready," which meant they needed little help from public employment offices and should find their own jobs; and the department told local offices to concentrate their efforts on placing disadvantaged workers. The department "helped" by launching a barrage of publicity on various federal programs that swelled the number of disadvantaged among job-seekers in local offices. A great many employers complained that local offices were referring candidates that were unqualified. Local offices developed a public image more like that of welfare centers than like that of employment offices.

The results were immediate. Between 1968 and 1969, years at the top of the business cycle, when unemployment was dropping and placement potentials were at their highest, the nonagricultural jobs filled by public employment offices fell by 10 percent nationwide, and by more than that in such large states as California, New York, Texas, Ohio, and Michigan. Only a handful of small states, probably those that had taken the risk of ignoring the new federal policy, ran counter to the overall national pattern.

The federal solution to employer disenchantment was not to restore the old policy, but instead to force employers to list their openings with public employment offices. Executive Orders 11598 and 11701, effective in June 1971 and January 1973 respectively, required all employers with federal contracts amounting to $10,000 or more to file all job openings paying less than $25,000 a year with local offices. Employers were not required, of course, to hire the candidates referred. So the result was predictable—a great deal more paperwork for all concerned, without a commensurate rise in placements.

At the same time the federal government began loading local offices with new functions, many having to do with the enforcement of various social policies: checking migrant housing conditions, registering and reporting food

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stamp applicants, and furnishing employers with data presumed pertinent to their affirmative action programs. This not only tended to damage their relations with employers further, but also, needless to say, consumed a great deal of state and local staff time, which detracted from placement efforts.

Presidents have long been calling for a reduction in the paperwork burden. But word has apparently not reached the Labor Department. On January 19, 1981, just before leaving office, Secretary of Labor Ray Marshall signed ambitious new regulations, further tightening the reins on state employment security agencies and putting the department's Employment and Training Administration into the business of data gathering, where it would compete with the Bureau of Labor Statistics and the Bureau of the Census. The "labor market information" that ETA now plans to gather is defined in the regulations as follows:

> Labor market information (LMI) means that body of knowledge pertaining to the socio-economic forces influencing the employment process in specific labor market areas. These forces, which affect labor demand-supply relationships and define the content of the LMI program, include population and growth characteristics, trends in industrial and occupational structure, technological developments, shifts in consumer demands, unionization, trade disputes, retirement practices, wage levels, conditions of employment, training opportunities, job vacancies, and job search information.

Who would have to create and move this prospective mountain of data? The state employment security agencies, naturally:

> State agencies, under the direction of ETA, with appropriate assistance from the Bureau of Labor Statistics . . . shall:
>
> (a) Develop and maintain an LMI program to collect, analyze, and issue information on current and anticipated labor market developments and opportunities for employment and training. . . .

Note the phrase "under the direction of ETA," and the word "shall." At a stroke this rule converts the state agencies into virtual arms of a massive federal data-collecting enterprise. Interestingly, the kind of information that is most pertinent to the primary functions of the state agencies is relegated to the bottom of the long list.

The statutory rationale for this enormous self-grant of power and authority is not impressive. The federal Wagner-Peyser Act of 1933 authorizes the Labor Department to assist the states in "furnishing and publishing information . . . of value in the operation of the [job placement] system." But surely the Congress intended some reasonable limit, short of infinity, on how much and what kinds of data would be "of value."

Most ironic is the fact that the department has not made a success of the massive data-collection system it already has in place. Its Employment Service Automated Reporting System (ESARS) was initiated about fifteen years ago. By 1975 its cost was conservatively estimated at $25 million per year. It produces monumental masses of minutiae, of questionable value, and it is much slower than the earlier, more useful, and far less costly system of manual reports. Many local offices, though not required to do so, prefer to maintain their own manual records.

THESE EXAMPLES, by no means all-inclusive, suffice to suggest that the federal father is as often wrong as right. And when he errs, all of his adopted children pay the price. If the states were given more leeway, through block grants, for example, they too might blunder from time to time. But the impact of a blunder would be limited to the state or states involved—while an experiment that turned out successfully could be taken up by other states, in the best tradition of our system of federalism.

Separation of control and responsibility violates the first principle of good administration. If the state employment security agencies are to succeed in their programs, they must regain authority commensurate with their statutory responsibilities. They need to have the latitude to experiment with new ideas in unemployment insurance. They need to be relieved of the welfare, enforcement, and other functions that detract from their placement efforts. They need to be free to attract employer job openings at all levels of skill, by recruiting and referring highly qualified candidates—without first checking for conformity with a five-foot shelf of federal regulations, manuals, guidelines, and directives. ■

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A Review Essay

About Knowledge and Decisions

William Havender

THOSE OF US who take part in the regulatory debate find ourselves forced by the sheer vastness and complexity of federal regulation to carve out small niches to work in. Like the blind men exploring the elephant, each of us gains detailed familiarity with only a fragment of the whole ungainly beast. Our ignorance of the rest of it tends to keep us from making generalizations that possess broad explanatory power and political impact, and also from striking strategically effective alliances.

All the reason, then, to appreciate Thomas Sowell's *Knowledge and Decisions* (Basic Books, 1980, 422 pp., $18.50). It is a powerful work that in the course of a wide-ranging examination of institutional decision making vividly illuminates many recurrent characteristics of regulatory action. No matter how different our specialties as students of regulation may be, these characteristics will elicit flashes of common recognition.

Sowell's argument builds on a seminal, though not widely known, essay published nearly four decades ago by Nobel laureate economist F. A. Hayek, entitled *The Use of Knowledge in Society*. Hayek maintained that economically useful knowledge consists not merely of rationalistic or "articulated" knowledge (that which could be set down on paper in a step-by-step development), but also of knowledge of local circumstances, subjective preferences, fleeting opportunities, and on-the-spot costs. This kind of transient and localized "knowledge" necessarily exists only in a dispersed form and, said Hayek, some economic systems are far better than others at mobilizing, coordinating, and disseminating it. In particular, an unconstrained price system efficiently transmits to all economic participants the current body of knowledge, however dispersed and evanescent, concerning the best use of a given resource. No one at the "center" need take an inventory of all possible sources of supply, all substitutes, or all alternative uses of a good in order to calculate the most efficient way to allocate it. A potential user need only respond to the structure of relative prices (indeed, he ignores this structure at his peril). In this way, the price system economizes on the knowledge any user must acquire in order to make a socially integrated decision—a useful outcome, since knowledge is not free. And a smooth allocation of limited resources among competing uses is accomplished without any single person having to understand the overall picture or will the specific result.

IT IS THIS NOTION—of inquiring into how social institutions mobilize and coordinate information and transmit it in the form of galvanizing incentives to decision makers—that Sowell applies so fruitfully in analyzing the actions of Congress, the courts, and the regulatory agencies. Such governmental bodies, argues Sowell, should be analyzed as though they "choose courses of action designed to maximize their own well-being under the particular incentives and constraints of their respective situations." From this point of view, they are as self-seeking as any business decision maker. Sowell stresses this point in order to take issue with the conventional wisdom, which readily "recognizes *non*governmental activities as self-interested but arbitrarily treats any governmental activity as axiomatic proof of an objective social need for such activity." Sowell examines these incentives to explain many otherwise puzzling institutional behaviors, and to show how biased

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and inaccurate information is transmitted from the rest of the society.

For example, the administrator of a regulatory agency can prosper, just as a businessman can, by discovering new "needs" for his "product"—regulation—and by fending off any changes that might make his "product" obsolete. Instances of agency action consistent with this motive are common, although of course a veil of "public interest," however fragile, is always advanced to mask the self-interest at work. The emergence of trucking as a competitor to railroads might have led, since it ended the monopoly that was the original justification for railroad regulation, to the withering away of the Interstate Commerce Commission. Instead, trucking was accused of skimming the most profitable business from the railroads and thus undermining the system of cross-subsidization that regulated monopolies often engage in. So the ICC's powers were expanded to cover trucking as well. Similarly, the Federal Communications Commission, using the excuse of protecting "free" TV, extended its regulation to cable TV, even though cable did not use the airways and indeed undercut the original monopoly element of broadcasting. Taking an example from my own field, the Occupational Safety and Health Administration set its "generic" policy on occupational carcinogens so as to settle all disputed scientific issues on the side of "prudence." This ostensibly was meant to provide maximum protection to workers, but it also happened to maximize the number of situations where OSHA's guidance would be necessary. And the Food and Drug Administration's obsession with saccharin, which was inexplicable as a reaction to demonstrated public harm, makes splendid sense when viewed as a test case that, if won in this instance where the evidence of human hazard was so hypothetical, would support FDA intervention in numerous other instances with slightly more substance. In other words, saccharin assumed importance because it—like the urine-marks a dog makes to define its territory—delimited a roomy perimeter for FDA action.

... the administrator of a regulatory agency can prosper, just as a businessman can, by discovering new "needs" for his "product"....

In this cynical view, emergencies and catastrophes can be seen to serve bureaucratic ambitions. The need to respond to such crises justifies the growth of agency authority, and—much more important—the need to prevent recurrences justifies the agency's retaining its new powers even after the crisis has passed. The view that crises compel a shy and reluctant government agency to expand simply ignores, writes Sowell, "the possibility that there are political incentives . . . to use episodic emergencies as a reason for creating enduring governmental institutions." The history of regulatory growth is, of course, littered with such examples: Love Canal spawned the toxic waste "superfund" legislation, and the Depression produced a rich crop of economic regulation that is with us yet.

IF, THEN, THE PEOPLE who run regulatory agencies respond rationally to incentives, how well and forcefully do these incentives transmit to decision makers knowledge that is needed for producing socially optimal decisions? It is not simply a matter, argues Sowell, of

> how well-informed the initial decision was, but how effectively feedback controls subsequent modifications, *regardless* of whether or not the decision makers want to change. Effective social knowledge . . . *forces* decision makers to adjust accordingly, both initially and subsequently, just as effective economic knowledge forces a business to adjust to consumer preferences under threat of bankruptcy. . . .
>
> Feedback which can be safely ignored by decision makers is not socially *effective* knowledge.

Sowell shows that there is a formidable array of obstacles that impede this transmission and seclude agency decision makers from forceful feedback.

Regulatory agencies with appointive personnel (the arrangement on the federal level) are not of course directly accountable to voters, as politicians must be, or to consumers, as a business must be. This is so despite formal requirements that agencies hold public hearings, since typically only those who are highly moti-

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vated can afford to travel to hearings and prepare testimony. So it is mostly "special interests" that take part in such hearings—industry representatives with a financial stake in the outcome and politically motivated activist groups (many with only tenuous accountability to their alleged constituency).

Special interests by their very nature, argues Sowell, bias the information flow to agencies. They not only grind their own financial or political axes at hearings, but also represent only the incumbents in the situation. Thus, it is the existing truckers or broadcasters that show up at ICC or FCC hearings, not those that might enter the industry in the future. People already occupying apartments are the ones who attend rent control hearings, not the people who may move to town next year. Occupational licensing boards tend to be run by current practitioners, not by their potential (still unlicensed) competitors.

Another reason for bad decisions, according to Sowell, is that agencies tend to apply rules categorically, rather than adjust them incrementally to specific circumstances. Even as simple a rule as the proscription of premeditated killing can lead to diminishing (and arguably negative) social returns in extreme cases such as "pulling the plug" on brain-dead patients, or executions. Regulatory rulings, about which there is far less consensus, can fall victim to the law of diminishing returns more readily. The Delaney clause, for instance, while perhaps laudable as a sentiment, would obviously cause social harm if it led to the banning of a food additive that had no substitute, that was a very weak carcinogen, and that had a large health benefit. (Just this argument was used to defend saccharin and nitrites.) Because any rule can run into situations where its enforcement is absurd, agencies should be willing to use their discretion to modify a rule's implementation in light of the informational feedback they get. Unfortunately, agencies also have countervailing motivations: they want to avoid the appearance of arbitrariness, they prefer simple to complex decision processes, and they are often anxious about the precedent that an exemption will create.

The fact that regulatory issues are legally and technically complex makes it difficult and costly to acquire the knowledge to understand them. This gives the agencies a forensic advantage, since they already possess up-to-date information on the issue; and it effectively bars large segments of the public from the debate, since they can easily be discredited over trifles. "Experts," writes Sowell, "can often devastate critics by exposing the latter's misunderstanding of . . . details . . . and technicalities—none of which may be crucial . . . but all of which . . . enable them to dismiss critics as 'uninformed.'" When the FDA commissioner announces the technical finding that in (so-called valid) high-dose animal tests nitrites cause cancer, or when a scientist working for the EPA finds that seepages from Love Canal damage chromosomes, or when the secretary of HEW endorses the belief that occupational exposures account for nearly 40 percent of all human cancer, there is no way that laymen can counter the claim. Only other scientists can. But having them review the data and perhaps carry out new studies will take months—or years. Often regulatory decisions, budget approvals, or legislative actions are pending and cannot wait while further information is developed. And while Sowell does not make the point, it is obvious that control over the *timing* of the release of new, policy-relevant technical information—or as a sour skeptic would say, the release of a new hare to chase—can itself affect the outcome of a pending decision.

Administrative agencies are also insulated from feedback because the division of authority originally envisioned in the Constitution as a brake on governmental arbitrariness has been seriously eroded. For example, regulations have the force of law, but they require neither congressional nor presidential approval; they take effect simply on publication in the *Federal Register*. And agencies in fact create more "law" in this way than does Congress! Also, the traditional constitutional and legal constraints on punishment are bypassed in the case of the many agency sanctions that take the form of the denial of benefits (revenue-sharing funds, subsidies, tax exemptions, grants, and contracts) rather than the imposition of penalties, making it possible to extract compliance without triggering the defenses built in against willfulness in criminal proceedings. The burden of proof, for example, is often placed on the defendant. Though agencies are formally subject to congressional oversight and judicial challenge, few agency actions in practice ever sum-

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mon the focused public concern necessary to motivate Congress (saccharin was a rare exception); and action through the courts is slow, expensive, and uncertain. These factors tend to shield agencies from effective feedback (and what there is comes, as noted, disproportionately from special interests), and hence permit them a wide scope for free-wheeling action.

Another source of bias arises from the process by which offered knowledge gets "authenticated," that is, sifted into "effective" and disregardable components. Generally, "articulated" information (arguments put into a scientific academic format) has much more effect than experiential testimony—which, however extensive, is easily dismissed as anecdotal and subjective. Again I find the saccharin case illustrative. There, the FDA received more letters than ever before—tens of thousands—from consumers objecting to the proposed ban (a case of feedback, if ever there was one). Yet the agency discounted this mass of personal testimony in favor of the frail "expert" evidence that had established only the *hypothetical* possibility of harm to humans, and no more than a very low maximum risk at that. As Sowell writes, "rationalism" at its extreme "exalts the most trivial or tendentious study by experts into policy, forcibly overriding the preferences and convictions of millions of people"—which is not an inapt description of the saccharin episode. As an instance of comparative institutional responsiveness, Congress, which also received a flood of letters but which faced the different incentive of having to account to the voters, speedily acted to postpone a ban.

In discussing the exaggerated role of "articulation" in authenticating evidence, Sowell provocatively observes that this role serves the interests of intellectuals. By placing the crown of objectivity, facts, and science on their own heads, they can discredit competing sources of decision making. Thus, corporations can be dismissed as biased, and consumers as ignorant or slaves of advertising. Requiring that articulated information be the only sort allowed into regulatory arenas increases the demand for those most adept at articulation, which just happens to be, land o' goshen, members of the intellectual class.

Sowell relates in this connection a brief history of IQ tests, whose advocates had a clear professional interest in discovering and promoting politically "relevant" applications for these tests, such as the screening of immigrants and military recruits, or the devising of government policies to improve the population through eugenics. The first of these tactics succeeded, in large part because of the claim that the views of IQ tests' proponents were quantitative, objective, inescapable scientific facts, quite distinct from the mere sentiment and baseless opinion of their opponents. That these victories enhanced the status, access to funds, and influence of the proponents was, we were to suppose, merely incidental.

... the modern regulatory state also has supplied pathways to public influence for specialists in normally obscure scientific disciplines.

What makes this tale particularly unsettling to me is that the modern regulatory state also has supplied pathways to public influence for specialists in normally obscure scientific disciplines. One need only recall the public role of cytologists, pathologists, and geneticists, all of them claiming the halo of scientific objectivity and concern for public safety, in the debates on Love Canal, nitrates, saccharin, aspartame, and malathion (the Medfly spray).

SOWELL'S RANGE OF CONCERN in this book is extremely broad. He makes his points with examples from many fields, including antitrust, minimum wage laws, wage and price controls, agricultural price supports, interest rate ceilings, rush-hour "pricing" for airports and expressways, restrictions on jitneys, import controls, the regulation of utilities, and many more. Also, although I have emphasized regulatory agencies here, he examines—as noted—legislatures and the courts for their effectiveness in transmitting knowledge from the broader society to decision makers. In sum, his rich book should be a real eye opener to those in the trenches of regulatory warfare. It supplies us with the broad generalizations and theoretical depth we need for devising coordinated strategies and pursuing our individual battles with conviction. ■

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Readings
of particular interest

The Route to Air Cargo Decontrol

Transition to a Free Market: Deregulation of the Air Cargo Industry by Andrew S. Carron (Brookings Institution, 1981), 45 pp.

Most deregulatory reforms in recent years have proceeded in scheduled stages rather than all at once. In this paper, Andrew Carron of the Brookings Institution examines the background of air cargo regulation, the transitional scheme Congress provided for deregulating that industry, and how that scheme affected the industry's structure and behavior.

The amendments to the Federal Aviation Act of 1958 enacted November 9, 1977, lifted controls from air cargo rates immediately, except for those that were "unjustly discriminatory, or unduly preferential, or unduly prejudicial, or predatory." It did not, however, allow full freedom of entry on routes for eighteen months, but instead loosened entry rules in stages: Carriers that already ran scheduled freight service could apply at once for unrestricted authority to operate both scheduled and charter services, and the Civil Aeronautics Board would have 60 days to grant its approval. Existing charter operators could apply for the same sort of unrestricted nationwide authority beginning April 1, 1978, about five months after their scheduled counterparts, and the CAB would have 45 days to decide on their applications. After November 1, 1978, anyone could apply for nationwide authority. The CAB would have 180 days in which to rule on the application, taking into account the applicant's fitness, willingness, and ability to run a cargo operation.

New carriers did not enter the market rapidly even after the barriers fell. There were several reasons. At the time of deregulation, Carron writes, there was an order backlog of up to four years for new freighters, and obsolescent passenger aircraft suitable for conversion to freighters were scarce. Airport space, likewise, was in short supply: at Chicago's O'Hare and San Francisco International, two of the busiest freight airports, one carrier could expand only if another gave up some of its facilities.

Among the first things the airlines did upon deregulation was to fill up planes that had been flying partly empty because of the rules barring domestic cargoes from international flights. Flying Tiger, for example, which had been touching down at Anchorage on its way from the United States to the Far East, could now for the first time drop off cargo there. Next, carriers began extending their route networks to new cities, "seeking to establish themselves in new markets before entry was permitted to others in the second year." Commuter freight lines like Federal Express, which had been limited by law to smaller planes, bought larger ones.

Some incumbent carriers had expressed fears that newcomers would have an advantage under deregulation because they were not burdened with newly obsolescent route structures and aircraft. The timetable delaying the entry of newcomers was to some extent a political response to this fear. But "[t]his timetable, which was the subject of much of the debate over the reform legislation, appears not to have constrained any carrier." Overall, Carron believes, "[n]ew entrants face the more formidable obstacles under deregulation."

In the cargo market, unlike the passenger market, concentration has increased under deregulation: the top four firms had 62 percent of scheduled cargo traffic in 1980, up from 55 percent in January 1978. This trend also reflects a pronounced shift in the industry away from the passenger airline, which carried substantial amounts of freight in the belly compartments of passenger aircraft, toward the specialized all-freight carrier.

Deregulation not surprisingly brought about large sudden gains and losses in wealth

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among various carriers. Carron believes these shifts would have been much the same even if transition policies had been different. The actual timetable that was chosen probably led to losses in economic efficiency, he says, though they were not large enough to be a cause for concern. Economic efficiency was not, he says, the leading concern of the lawmakers who crafted the timetable: the "[t]ransition was, in fact, a means of gaining support for reform and not a means of implementation."

Shippers' Views of Transport Deregulation

"Report on Harbridge House Survey of the Impact of Transportation Deregulation on Major U.S. Manufacturing Firms" (Boston, Mass.: Harbridge House, June 1981), 26 pp.

In May 1981, Harbridge House, Inc., a management consulting firm, asked 2,200 large businesses how deregulation and regulatory reform in transportation had affected them. Two hundred and twenty-four firms responded. Their answers suggest that for many shippers, improvements in the quality of service may have been as important a benefit of deregulation as lower rates. Moreover, while both larger and smaller shippers appear to have been helped by deregulation, large shippers may have been helped more than smaller.

Quite a few firms had expected the effect of deregulation on service to be mixed or bad. The firms that expected to lose rail and air freight service, for at least some company locations, outnumbered those that expected improved service. Predictions for trucking deregulation were more optimistic, but even there one in thirteen firms expected to lose some service.

When the various deregulation schemes took effect, however, service tended to get better, according to the firms surveyed. The most notable improvements were in full-truckload shipments, including such categories as the availability of equipment (39 percent thought it had improved, and only 3 percent said it got worse); transit time (30 percent said it was better, 2 percent worse); transit time reliability (29 percent better, 2 percent worse); and service frequency (34 percent better, 2 percent worse). Truck shipments of less than full truckloads also registered improvements by smaller but still lopsided margins.

Rail deregulation, whose effects on service had been widely feared, was quite popular after the fact. Each of the four major service factors listed above was given an improved rating by 10 to 16 percent of shippers, while only 3 to 4 percent of shippers saw a deterioration. Few respondents thought that the quality of service on air cargo transport had changed much. Transit time reliability received the most favorable comments, while transit time itself drew mixed comments (7 percent better, 5 percent worse). [One reason all of these percentages are low is that a large number of respondents—25 to 35 percent for trucking, 40 percent for rail, and 55 to 65 for air cargo—offered no opinion on the query, perhaps because they were not major users of the mode in question.]

Shippers say the quality of service is very important to them. Asked to name the single factor that was most important in full-truckload shipping, more named equipment availability than named rates, and significant numbers named other service factors. Speed and frequency were especially important for less-than-truckload shipments. Equipment availability and transit time reliability were cited by many rail users. Transit time and reliability were the key factors for air freight shippers.

Under deregulation, the cost of transportation generally decreased. Trucking rates fell for a large majority of shippers and air freight rates for a plurality. On rail rates, however, responses were evenly split. Since the perceived quality of service also improved, it was no surprise that the shippers' overall estimation of deregulation was positive. Trucking deregulation was viewed favorably by 74 to 21 percent; rail, 47 to 27 percent; air freight, 38 to 23 percent; and air express, 37 percent to 12 percent.

Larger companies tended to support deregulation more consistently than smaller ones. The average firm that favored trucking deregulation spent about 20 percent more on trucking (and on transportation generally) than the average firm that opposed it. For rail deregulation, the firms in favor had higher sales and higher overall transport costs—but not, for some reason, higher rail costs—than the firms against. Air freight and air express deregulation likewise won more support from larger firms.

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Exploring the Alternatives to Government Regulation

Two recent books explore slightly different facets of a single theme—alternatives to government regulation. The first considers various private and public sector arrangements that might serve in the place of regulation, and examines the legal roadblocks to agency use of such arrangements. The second makes the case for abolishing or curtailing specific federal agencies and replacing them with nonregulatory institutions.

• *Alternatives to Regulation: Managing Risks to Health, Safety and the Environment* by Michael S. Baram (Lexington, Mass.: D.C. Heath and Company, 1982), 245 pp.

Michael S. Baram of the Franklin Pierce Law Center seeks to identify "why . . . nonregulatory options succeed in some respects and fail in others and what can realistically be done to remedy their failings." Baram's alternatives to regulation include common law remedies, such as those for negligence, product defects, nuisance, and trespass; industry self-regulation and professional licensure and certification; means of indemnification, such as workmen's compensation, government-subsidized insurance, and bonding, escrow, and restoration funds; and government initiatives short of direct industry regulation, in such areas as procurement and public information.

While there is a remedy under common law for "virtually all" environmental risks, he says, most of them are "beset by problems." The costs of litigation may be high, and it may be difficult to establish proof of the wrong done. Also, the remedies may not provide sufficient incentives to prevent the injuries they are designed to combat. Still, agencies can often use their own resources to strengthen the process of private litigation. The Environmental Protection Agency, for example, could adopt a manifest system to track hazardous wastes through their life cycle, so that in cases of misconduct private litigants could identify the particular handler responsible. In the field of safety regulations, the National Highway Traffic Safety Administration could provide standards, testing, and research that would make it easier for insurance firms to charge differential rates for different auto models. If the government prescribed standards for high-voltage electric transmission lines, the author suggests, those who suffer injuries caused by the lines might recover damages in a negligence suit without having to hire expert scientific witnesses to testify in their behalf.

Baram argues for giving agencies wider legal discretion to experiment with alternatives as a formal part of the rulemaking process, or perhaps even requiring them to choose nonregulatory alternatives where feasible.

The use of nonregulatory alternatives, however, now usually faces legal obstacles. Some "agency-forcing" laws require agencies to regulate. Even where there is no such law, an agency's deliberate decision to rely on an alternative may be construed by a court as the functional equivalent of a rulemaking, and thus may be subject to the requirements of the Administrative Procedure Act. If the agency compiles a detailed record in the course of deciding not to resort to a regulation, a court may rely on that record to force it to regulate willy-nilly. Agencies that rely on public information policies may run afoul of the Trade Secrets Act and the Privacy Act of 1974. Baram says that "Congressional action, judicial tolerance, executive guidance, and responsible agency initiatives" are all needed to clear the path, where appropriate, for agency innovation.

• *Instead of Regulation: Alternatives to Federal Regulatory Agencies*, edited by Robert W. Poole, Jr. (Lexington, Mass.: D.C. Heath and Company, 1982), 404 pp.

Robert W. Poole, Jr., of the Reason Foundation brings together in this volume eleven essays that explore, area by area, ways in which particular regulatory agencies might be abolished. The general theme of the essays, Poole notes in his introduction, is "the return to individuals of substantial decision-making power" through the removal of prior restraints on the actions of both producers and consumers.

Poole's volume considers the impact of deregulation in airlines, air safety, ground transportation, energy, communications, consumer protection, investor protection, drugs, product safety, worker health and safety, and pollution control. Ida Walters of the First National Bank of Chicago calls for opening up telecommunications markets completely to competition,

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right down to local telephone exchanges, and allowing broadcast frequencies to be privately owned. David Leo Weimer of the University of Rochester argues that it would ensure the safety and improve the availability of prescription drugs to end most Food and Drug Administration regulation, while retaining certain existing protective mechanisms—for example, laws against labeling and advertising fraud and institutional review boards to ensure drug safety. Roger Meiners of Emory University proposes to replace the Consumer Product Safety Commission with a rule of strict producer liability in personal injury lawsuits. He also calls for changing antitrust law to allow voluntary agreements among manufacturers to set product-quality standards. Peter Aranson, also of Emory University, advocates decentralizing pollution control to the smallest possible units, arguing that there are "no truly national pollution problems" and that competition among cities and states would best balance the competing interests involved.

Poole says that it may be easier to implement alternatives for the most recently created agencies than for the older ones such as the FDA and Federal Aviation Administration. It is not that the inherent problems are necessarily greater in the older areas; rather, he says, the "legal and marketplace mechanisms that exist in other fields have atrophied in these protected domains."

How Polluters Pay in Other Countries

Compensation for Pollution Damage (Paris, France: Organization for Economic Cooperation and Development, 1981), 208 pp.

The theory of charging fees for pollution and using the money to compensate victims has become familiar in the past several years. The seven papers in this volume trace actual efforts to apply such compensation methods, ranging from relatively traditional liability procedures to innovative compensation funds, in some of the twenty-four industrialized countries that are members of the Organization for Economic Cooperation and Development.

The first two papers argue respectively for and against the view that liability procedures are a reasonable way to compensate the victims of pollution damage. In the first, Emmanuel du Pontavice of the University of Paris and Patricia Cordier note that pollution liability has grown more comprehensive. While Western legal systems traditionally do not hold persons liable for the damages *indirectly* caused by their acts, the authors say, in pollution cases the courts of most developed nations have made an exception. Thus, in the case of coastal oil spills, French, international, and U.S. case law, as well as international agreements like the 1969 Brussels Convention and the 1976 London Convention, have recognized that some parties that do not suffer direct property losses may be entitled to compensation. French hotelkeepers and shopkeepers near polluted areas, whose property suffered no actual damage, have successfully sued for loss of tourist trade.

Gilles Martin of Nice University argues that liability suits are inherently unfit vehicles for setting pollution damages, and that as a result French courts have distorted liability law inefficiently in pursuit of equity. The courts, he says, have partially abandoned "fault"—as established by the illegality of the polluting act—as the criterion for liability. But because they recognize society's need to allow some polluting activities, even some that are technically illegal, they rarely award full compensation to the victims. This makes for unequal and unpredictable compensation, Martin says. He argues that if society is going to permit people to pollute so long as they pay a fee, it ought to adopt legal tools explicitly designed for such a purpose.

The next two papers, by Martine Remond-Gouilloud of the University of Paris and Patrick Renyers of the OECD Nuclear Energy Agency, give detailed surveys of the specialized legal institutions that industrial countries have applied in two special cases of pollution damage: pollution at sea and damage from nuclear facilities. In both cases international conventions impose strict or nearly strict liability on operators, coupled with ceilings on their overall potential liability. Oil tankers are subject to stricter pollution insurance rules than fixed offshore facilities, since "the ease with which a ship can escape pursuit [helps make] it the very archetype of the potential bad debtor."

Jean Bigot of the University of Paris examines the reasons why insurance taken on by the polluter is not now a widespread means of pollution compensation. Pollution damage is

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rarely covered by insurance unless it is accidental, sudden, and unforeseeable. (An exception is that in the countries surveyed there has been an increase in insurance coverage of "residual" pollution damage—that is, unforeseen or abnormally severe damage from conscious and lawful pollution.) Insurers, moreover, are disposed to insure only those cases that the polluter can most easily defend—those where the plaintiff must prove liability.

Thus a voluntary insurance system will not by itself compensate most victims of polluting activities. Even if polluters are not insured, of course, some victims will be able to recover damages in court. Bigot suggests insurance be made compulsory for high-pollution industries, but also suggests that potential victims should buy their own insurance, just as they now insure themselves against fire and ill health.

Volker Thiem of the Max Planck Institute analyzes environmental damage funds in Holland, France, Japan, Canada, and in this country (in Maine). "In certain respects such a fund resembles a form of compulsory insurance," Thiem says. "It is in the improved enforcement of claims that the compensation fund is of decisive value." And while liability procedures for compensation have been highly complicated by considerations of equity, compensation funds are at the other end of the scale of simplicity.

Japan's Fund for Pollution-Related Health Damage is intended to compensate for the Japanese government's conscious policy of encouraging economic growth and industrial development. The fund pays claims on the basis of standardized epidemiological evidence: people who live or work within a zone in which pollution has been shown to be a frequent cause of certain health problems can win free medical treatment simply by showing that they suffer from one of those problems. Extensive epidemiological research was done before the zones were created in 1969. The fund is financed by a tax on pollution emitted in the various zones and by a portion of the motor vehicle tax. For some pollutants, firms are assessed according to the volume of their emissions.

Unlike Japan's Thiem says, most environmental funds do not deal with damages to health. (Japan, he notes, is the only one of the countries without an extensive compulsory or near-compulsory health insurance system.) The Dutch air pollution fund, raised by a levy on fuels, covers only cases where it is impossible to identify and fine specific polluters, and where there are no other sources to compensate victims. Most successful claims have been for crop and animal damage. France has a fund financed by airlines to compensate Paris homeowners for airport noise and a fund financed by hunters to compensate farmers for crop damage caused by big game.

The funds do not always achieve a proper deterrent effect, Thiem says, because their tax structure does not reflect the actual extent of the pollution damage. The Japanese motor vehicle tax relies solely on the weight of the vehicle, not its emissions. Likewise, the French airport noise levy is tied to the number of passengers and destination of a flight, so that "environmentally preferable types of aircraft [such as the 300-passenger Airbus] are often more heavily taxed than environmentally undesirable aircraft," such as the 120-passenger Concorde.

Minimum Wages and the Poor: American and British Evidence

• *Poverty and the Minimum Wage* by Donald O. Parsons (American Enterprise Institute, 1980), 62 pp.

The effects of minimum wage rates vary significantly among demographic groups. They directly affect relatively few adult men, mainly southern blacks working in agriculture. On the other hand, 50 percent of black adult women workers and over 20 percent of white adult women workers held jobs that paid the minimum wage or less as of 1967.

Donald O. Parsons of Ohio State University considers in this monograph the effect of minimum wage laws on poor women, the demographic group best situated to benefit from them. Several major studies have suggested that adult women are made relatively better off by minimum wage laws at the expense of teenagers of both sexes, Parsons says. Wage rates for adult women with fewer than twelve years of schooling in 1967 were significantly higher in the manufacturing sector, which was largely subject to the minimum wage, than in the service sector, which was not. It is plausible to assume that the minimum wage accounted for some of the difference. A 1972 study by Marvin

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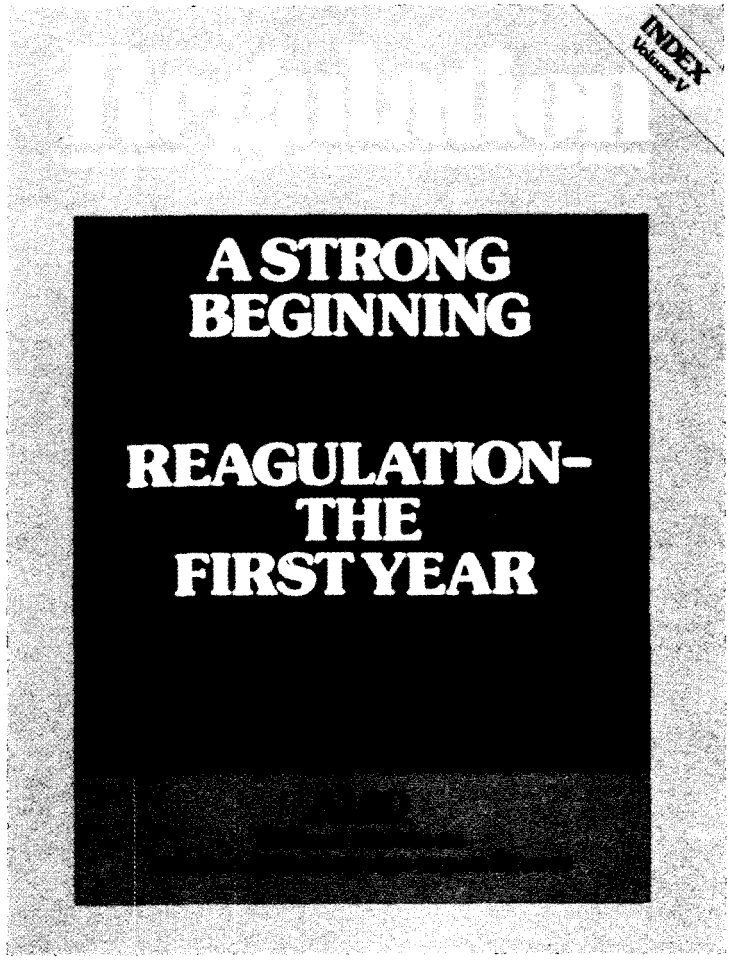

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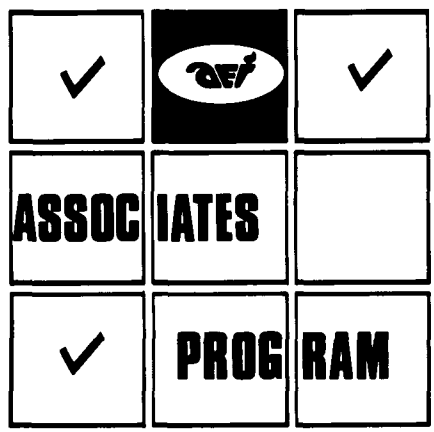

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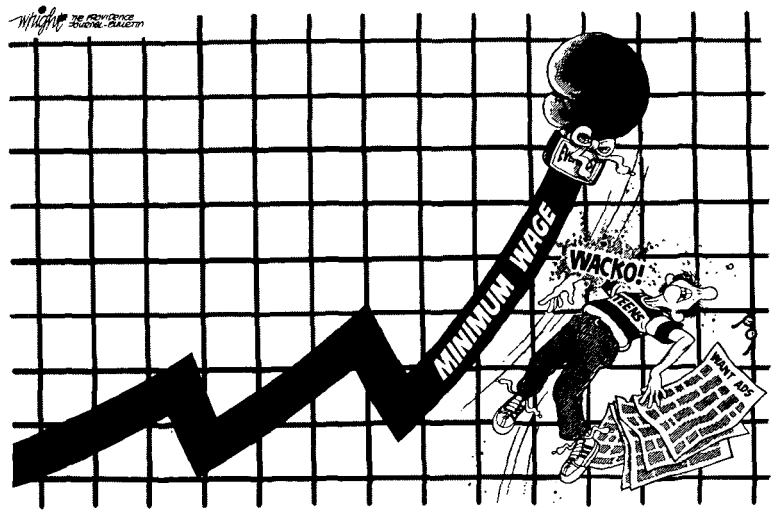

Kosters and Finis Welch found that increased minimum wages had reduced the business cycle instability of adult white women by a quarter, left instability unchanged for adult black women, and doubled instability for teenagers.

This finding suggests that a possible rationale for minimum wages may be income redistribution. If they transfer earnings from teenagers to adult women, and more of the latter live in poverty than the former, then they may succeed in shifting income from the better-off to the worse-off. Parsons's analysis, however, concludes that the added earnings the minimum wage secures for low-paid women are "extremely small."

From 1967 to 1974 the minimum wage was all but repealed by inflation and productivity growth, falling by 30 percent compared with average wage rates. Parsons says that relative wage rates for low-skilled women in jobs covered by the law fell about 10 percent during this period—each woman losing, on the average, somewhere between $150 and $400 a year—while uncovered workers showed no gain or loss. However, the total amount of money earned by all low-wage females remained a constant proportion of all earnings during the period Parsons studied, in part because their employment in the covered sector apparently grew fast enough to offset their relative wage decline there.

From 1974 to 1976 the minimum wage increased by 44 percent, and coverage was significantly expended in nonmanufacturing sectors of the economy. During that period the relative wage rates of women working at low wages in those sectors rose by 10 to 20 percent—more evidence that the minimum wage was altering the wage structure in the intended direction. If the amount of work available to these groups had not suffered a relative decline, the average earnings of low-wage women would have risen by $348 a year for blacks, and $210 a year for whites. In actual fact, the relative employment levels of these groups declined significantly, which reduced the above figures to $136 and $12 respectively. Parsons does not estimate how much of the relative employment decline was due to the minimum wage and how much to the general business downturn that occurred during this period.

Less than half the earnings reallocated to women by the minimum wage may have gone to poor women, Parsons claims. In 1974, 70 percent of white and 45 percent of black adult females earning the minimum wage or less belonged to families that did not live in poverty. Moreover, many women whose annual earnings were very low were not directly affected by the law: 45 percent of white and 21 percent of black women earning less than $1,000 in 1974 earned well over the minimum hourly rate.

The total gain to women living in poverty from the 1976 minimum wage structure, according to the author's estimates, was between $130 and $600 million. This sum amounts to only between 0.1 percent of total expenditures on social welfare, and must be balanced against the job losses experienced by teenagers of both sexes. "The extremely modest gains to the demographic group most likely to be favorably positioned to benefit from minimum wage laws, adult females, must raise serious questions about the economic justification of such laws."

• *Low Pay, Occupational Mobility, and Minimum-Wage Policy in Britain* by David Metcalf (American Enterprise Institute, 1981), 83 pp.

Although the United Kingdom does not have a national minimum wage law, it has used a number of other measures intended to raise the wage rates of low-paid workers and flatten out differences in earnings among workers. These

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laws come under three general headings: laws providing for "wage councils" to set minimum wages in particular industries, prevailing wage laws applying to government contractors and formerly to other private employers as well, and wage-price controls ("incomes policies") that have sometimes tried to improve the relative standing of low-wage workers.

David Metcalf of the University of Kent looks at how the lowest-paid part of the British work force has fared under these policies. He concludes that the "distribution of earnings has remained pretty constant in the last decade"—perhaps even the last century—and that "egalitarian pay policies have not compressed the overall distribution."

"One in six adult full-time workers is low paid," Metcalf writes. "But the extent of the underpayment represents less than 3 percent of the wage bill." Most low-paid Britons live in households with more than one earner, and "the overlap between low pay and poverty is modest."

Since 1909 Britain has had a system of "wage councils" that set minimum wages in various low-paying industries. In 1978 there were forty-one such councils, setting pay rates for 2.75 million workers employed in 391,000 places of business. Wage councils originated in tiny, highly specialized trades like lace-making and net-finishing, and even now the scope of many of the councils is very small: the Coffin Furniture and Cerement-Making Council covers forty firms and the Pin, Hook and Eye, and Snap Fastener Council a mere nine.

Wage councils are established and dissolved by the government's employment minister. Each one includes an equal number of employer and worker representatives, along with not more than three outside members, one of whom serves as chairman. After negotiations between the two sides, in which the independent members serve as mediators, the councils arrive at minimum terms for wages, holidays, and other conditions of employment.

Apparently wage councils have not done well in their aim of raising pay for low-paid workers. Since 1950 minimum wages for unskilled workers covered by wage councils have fallen substantially relative to those of unskilled workers covered by national union contracts. A "particularly important" reason, Metcalf says, is that wage councils have been much more likely to obey government anti-inflation guidelines—possibly under the influence of their "independent" members—than have unions and firms outside the council sector. Even within the council sector, low-paid workers have not gained ground relative to their higher-paid colleagues. Overall, Metcalf finds "no evidence that wage-council workers have improved their relative position."

Britain has been setting "fair wages" for firms engaged on government contracts since 1891. At first, contractors were held to the terms of recognized union contracts in their field. The law was changed in 1946 to require that contractors pay the prevailing local wage even in the absence of a recognized union contract. In 1975, the Employment Protection Act extended the prevailing wage requirement from government contractors to the entire private sector, except in industries where there was a recognized union contract. This change, Metcalf says, "was of some minor help to low-paid individuals, although its aggregate impact was negligible." It was repealed in 1980.

Through most of the 1970s, the British government pursued an "incomes policy" using wage guidelines, some statutory and some voluntary, calculated under a succession of seven different formulas. Most of the guideline formulas were to some extent egalitarian in purpose, allowing larger percentage increases at the low end of the pay scale than at the high end. In practice, however, the distribution of earnings among high-paid and low-paid workers remained "remarkably stable" under the guidelines. According to Metcalf, the devices employers used to get around the guidelines—upgrading job descriptions, paying new workers higher wages, and so on—tended to work to the advantage of high-paid workers. Furthermore, since wage councils usually obeyed the guidelines, their low-paid employees actually lost ground during the period.

The distribution of earnings in Britain has, in fact, been stable for nearly a century. In 1886 the cutoff point for the lowest-paid tenth of manual workers stood at 68.6 percent of the median wage. In 1979, the corresponding figure stood at 68.3 percent. "It is clear," writes Metcalf, "that wage councils, fair wage policies, and incomes policy have not achieved a redistribution of earnings."

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(Continued from page 4)
rected egregious errors by the staff and the commission itself in filing misguided complaints. Thomas Campbell would have us believe that prosecutions of trivial price-fixing cases are necessary to convince all businesses that the law will be enforced no matter how silly the violation or how great the resource commitment. He also ignores the FTC's constant use of its prosecutorial authority to "fix" the competitive contest in favor of those with greater political skill. And he rewrites the record on antitrust prosecution of professional groups, which in fact was initiated by the Justice Department several years ago, before the FTC belatedly jumped on the bandwagon.

Robert Pitofsky, on the other hand, blames the FTC's price-fixing prosecutions on the Supreme Court, rather than the commission itself. But the Court's comments on the subject during the past dozen years consist only of dicta—and cannot be held responsible for the FTC's persistent commitment of resources to trivial cases in this area. Of course, he (and Campbell) are right that a summary review like mine must simplify matters and that a longer essay could provide fuller details on my criticism of particular cases. What he fails to address is the overriding question of why, as he concedes, so many FTC complaints are persistently wrong-headed.

More interesting, in this respect, are Thomas Armitage's responses to my view that the FTC's miserable record is due in part to its inconsistent consumer protection responsibilities and special vulnerability to interest-group pressures. He misreads my argument on the first of these two, seeing it as a claim that the FTC never could develop a rational consumer protection program (an issue I did not address) and he never says whether the interventionist bias of the current program has in fact skewed the agency's antitrust performance. The interest-group pressure argument, moreover, focused more on the FTC's pursuit of a few appliance dealers and tiny apparel manufacturers than on the oil company case.

Armitage's analysis of some factors that affect the FTC's performance is useful, and I agree with his suggestion that what one person sees as improper pressure, another sees as principled analysis. Unfortunately, he leaves us with no explanation or further understanding of why the FTC's antitrust record is such a dismal one.

Government and Science

TO THE EDITOR:

William Havender's "Politicians Make Bad Scientists" (*Regulation*, November/December 1981), which reviews the massive work of Sir Richard Doll and Richard Peto, focuses on their criticism of two government papers on the causes of cancer. As Havender mentions, the Doll and Peto monograph (*Journal of the National Cancer Institute*, June 1981) is far more than an attack on those two papers: it is a thorough description of what is known about the causes of cancer in the United States today. In the course of that description, the authors refer often to articles published by government scientists in scientific journals, and some of their arguments depend on the data generated by and the conclusions reached by government scientists.

To characterize the two government reports as "science" may be, as Doll and Peto point out, inappropriate. If so, it would be preferable to regard the authors of those reports not as scientists but as government officials making policy statements. This creates some difficulty, since it may be less than obvious which role, scientist or policy maker, an individual is playing. But it would remove the temptation of asking, as Havender did, "How good a scientist is government?" In fact, as we all know, government employs many scientists. Like scientists anywhere, some are very good, some good, and some not so good. It is impossible to decide how good a scientist government is. Government is not a scientist.

Finally, Doll and Peto acknowledge in their opening paragraph that their study was commissioned by the Office of Technology Assessment. That is to say, they produced the paper in response to a request from government scientists. The Doll and Peto paper was the basis of part of OTA's 1981 Assessment of Technologies for Determining Cancer Risks from the Environment. Efforts by government employees that please individuals with certain convictions might be acknowledged as freely as the displeasing ones are criticized.

Michael Gough,
Office of Technology Assessment

WILLIAM HAVENDER responds:

Had I opened my piece with the question, "How good a scientist is industry?" I rather doubt that Gough would have replied in his somewhat huffy manner, "In fact, as we all know, industry employs many scientists. Like scientists anywhere some are very good, some good, and some not so good. It is impossible to decide how good a scientist industry is. Industry is not a scientist." Instead, I expect that he would have easily recognized my question as an allusion to and an abstraction of the reigning *Zeitgeist* —namely, the taken-for-granted presumption that researchers and scientific organizations receiving industry funds must automatically be tainted, and their statements should accordingly never be accepted on faith but instead subjected to searching examination when not rejected outright.

Analogously, the question that I did ask was directed—and I think this should have been obvious from the context in which I put the question—to the indulgent *Zeitgeist* presumption concerning statements coming from government officials in the name of science and bearing on upcoming regulatory decisions. Under this presumption, such statements may be taken in good faith as essentially valid or at least honest, since government, unlike profit-seeking industry, has no motives other than to search for truth. The instance I highlighted, which was solidly documented by Doll and Peto, shows that this presumption can be wrong on both counts: not only was the Califano report inept at a very elementary level, but the attempt that was made to funnel its novel conclusions directly into policy-making arenas while bypassing the normal scientific practices of identified authorship, peer review, and journal publication casts a grim light on its integrity as well. Given the wide ramifications that the Califano report might have had on regulation, industry, consumer and worker welfare, and the general economy, this is no minor matter. And because there are other instances where novel scientific findings, shown only much later to be in error, have been hastily used by government officials to influence pending regulatory decisions, this failure of the presumption is by no means unique. Since this presumption, concerning not basic science itself but the process by which government *uses* science to shade policy making, is what I wished briefly to point up and to question in my introductory sentence, I think the query "How good a scientist is government?" was, *pace* Gough, just the right one to ask. ■

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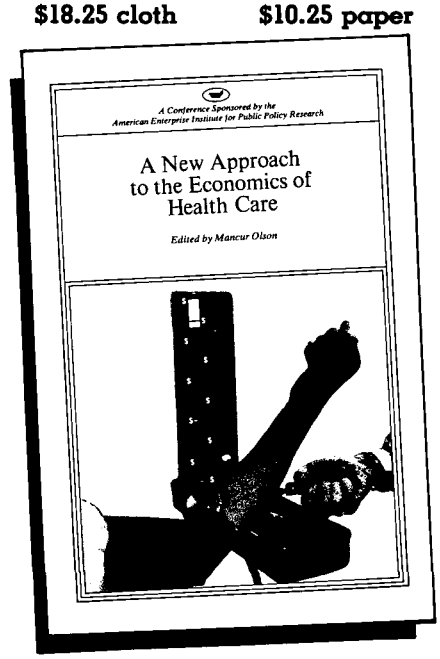
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